S. HRG. 103–480

# INTERSTATE BANKING AND INSURANCE ACTIVITIES OF NATIONAL BANKS

 RINGS

BEFORE THE

## COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

NATIONWIDE BANKING AND BRANCHING AND THE INSURANCE ACTIVITIES OF NATIONAL BANKS

OCTOBER 5 AND NOVEMBER 3, 1993

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



U.S. GOVERNMENT PRINTING OFFICE

77–902 CC WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-044118-8

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# INTERSTATE BANKING AND INSURANCE ACTIVITIES OF NATIONAL BANKS

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TUESDAY, OCTOBER 5, 1993

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, DC.*

The committee met, pursuant to notice, at 10:10 a.m. in room 538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

## OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The CHAIRMAN. The committee will come to order.

Let me welcome all those in attendance this morning. We have a very important subject to cover today, and I want to move through what is a distinguished and important list of witnesses. We have the two party caucuses that will occur at the lunch hour, so I want to try to make sure everybody has a chance to be heard and that we have a good opportunity to question our witnesses.

I want to indicate that Senator D'Amato very much wants to be here. He is handling a bill on the floor right now, and the conflict was inescapable. He wanted me to indicate that and say that if he is able to break loose and get here, he will, but he may not have that chance given his responsibility on the floor.

At today's hearing the committee is going to examine the subjects of nationwide banking and branching and the insurance activities of national banks. We have asked our witnesses today to testify on the provisions of S. 543 dealing with these matters, which were in fact passed by the Senate on November 21, 1991, and reported favorably out of this committee. So these are not new topics. These are topics that have been before us over a length of time. We've acted on them previously and there is an abundant committee record as to both the positions that people have expressed and also actions that the committee has taken.

It is my intention to have the committee mark up legislation on these issues in November 1993, and this hearing will be the first layer of the foundation in that effort. I anticipate doing this on a bipartisan basis, as we did previously in 1991. There will be different points of view, and we will work to reconcile those as we move through the legislative process.

The United States presently has a national policy of giving States control over the geographic expansion of both national and State banks whether that expansion takes place by acquisition or takes place by branching.

In recent years almost every State has adopted legislation permitting bank holding companies from out of State to come in and buy banks in that State and maintain them as separately chartered banks. But these State laws are not uniform and thus restrictions still remain on what one would think of as a streamlined nationwide banking system. In addition, nationwide branching is effectively prohibited. Likewise, holding companies cannot turn a newly acquired bank into a branch of the main bank.

Now proponents of nationwide banking and branching argue that restrictions on interstate banking result in costly inefficiencies and reduced competitiveness. They argue and believe that consumers would actually benefit from increased competition and the convenience of being able to use bank branches in more than one State as people move around the country.

Others who take the other side of this issue warn that removing these restraints could lead to an overly concentrated banking system. They express the fear that large multistate banks would drain deposits from local communities. They say that community bankers are also concerned about competing with the large institutions that could open branches in their town.

In 1991 the legislation passed by the Senate permitted bank holding companies to both acquire existing banks in any State and also to combine their bank subsidiaries in different States into a single main bank with branches. These provisions, although they passed the House as an amendment to one banking bill considered by that body back in 1991, were not in the final House bill as it came into the conference and were not accepted by the House in our 1991 conference on FDICIA.

Like interstate banking, the regulation of insurance has traditionally been handled at the State level. This is a very significant fact. It's sort of a simple fact, but it has enormous complexity associated with it, and we do not as such regulate insurance at the Federal level. That is one of those responsibilities that has been retained by the States. So you find a pattern of varying insurance regulatory schemes across each of the 50 States. Many States, in fact, have prohibited the banks they charter from selling insurance.

In 1916 Congress enacted a law allowing national banks located in towns of 5,000 people or less to be able to sell insurance. Seventy years later the Comptroller of the Currency interpreted this provision to allow a bank branch in a town of 5,000 to sell insurance to any individual or business in the entire United States.

After 7 years of litigation, the District of Columbia Circuit Court recently held that the Comptroller's interpretation is "permissible." Well that interpretation may be permissible as a matter of law, but many in Congress believe it is not appropriate.

S. 543, the banking bill passed by the Senate in 1991, clarified that a national bank in a town of 5,000 may sell insurance only to individuals and businesses in that town and certain surrounding rural areas. It did not envision using that as a base to sell across the country.

It further placed national banks on the same competitive footing as State banks by allowing a national bank to sell insurance to the same extent as State banks in a State where it is located. There was some effort to try to establish comparability in that fashion.

Unfortunately, the House of Representatives did not pass comprehensive banking legislation in 1991, and the interstate banking and insurance sales provisions that I have just described, that were worked out here in the Senate, were thus not enacted into law.

Now much has changed since that time. Since that 1991 time period, when these issues were at play, we have elected a new President and we have elected a new Congress. We are now in the midst of bringing these issues forward again. We have scheduled a second hearing on November 2, 1993. So today's discussion will kick us off, but we will be moving forward on that kind of a timetable.

I want to say again, it's my intention to have the committee mark up legislation dealing with these issues sometime in November.

Let me now ask unanimous consent that remarks by Senator D'Amato be placed in the record at this point.

Senator Mack, did you have a comment you wanted to make, and then I want to go to our two colleagues back and forth here.

## OPENING COMMENT OF SENATOR CONNIE MACK

Senator MACK. Mr. Chairman, I will forego an opening statement this morning, contrary to the tradition of the committee of lengthy statements. I'm looking forward to hearing from witnesses.

The CHAIRMAN. Thank you very much.

Senator Murray.

## OPENING COMMENT OF SENATOR PATTY MURRAY

Senator MURRAY. I second that.

The CHAIRMAN. Very good.

Senator Roth.

## OPENING STATEMENT OF SENATOR WILLIAM V. ROTH, JR.

Senator ROTH. Mr. Chairman, I would also like to join in welcoming today's witnesses before the committee to speak on the important issues of interstate banking and branching as well as the authority of national banks to sell insurance in towns of 5,000 population.

Someone fresh to the ways of banking legislation may wonder why two such different issues should be paired together. There seems to be a curious line of reasoning for legislation with economic impact that if a proposal favors one group, like the banks, then another proposal that disfavors them needs to be added. This reasoning treats economic regulation as a zero-sum gain in which the function of Congress is to budget plusses and minuses for various parties, and this approach overlooks that the real test of any proposal should be how it affects the American people. If a given proposal is good for the public then, in my opinion, something bad for the public need not be considered as an offset.

Proposals to allow banks to branch interstate hold forth the promise of many benefits which flow from the unitary status of the parent bank with its branches to be enjoyed under the legislation. But I remain puzzled and troubled just how the proposals would work in a Federal system. The proposals appear to allow the States to treat branches in their respective jurisdictions as separate from

the parent, for the purpose of regulation, while the banks enjoy the benefits of an integrated, unitary status.

I wonder, for example, once banks are converted into branches, whether the parent bank will be able to export the interest rates of the home State into the branch State? If it cannot, many credit card operations will be upset by the legislation.

Furthermore, I wonder whether the legislation is truly revenue neutral with respect to the revenues of each individual State? If a State like Kentucky taxes the corporate status of the banks in that State and those banks lose that status when they're converted into branches, does that affect Kentucky's revenue?

Will States that host a branch be able to lay a greater claim to tax incomes of a present bank on the basis that the parent exists in the host State through its branch? If so, this could trouble the very institutions that hope to gain under the legislation.

In addition to the interstate branching issue, this hearing will also focus on the authority of national banks to sell insurance products.

During the consideration of FDICIA legislation in 1991, I was quite interested in several insurance issues which impacted on the authority of State chartered banks, particularly those in my State of Delaware. And since today's hearing focuses on the authority of national banks, not State banks, to sell insurance, the issue does not raise the same federalism concerns.

As for the authority to sell insurance in small towns, I suspect this is one more issue where a page of history is worth a thousand of logic. The authority is not very pretty, but it does function in ways that help the American public. The authority does serve the general public, and it's hard for me to understand why it should be rolled back to offset some other provision.

Mr. Chairman, I look forward to the testimony of the distinguished witnesses today. Thank you.

The CHAIRMAN. Thank you, Senator Roth.

The Chairman of the Budget Committee, Senator Sasser.

## OPENING STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Thank you, Mr. Chairman.

I want to welcome our distinguished panel of witnesses here this morning and I want to thank you, Mr. Chairman, for convening this very important hearing.

A few weeks back this committee, with overwhelming bipartisan support, took steps to reduce the paperwork burden on the Nation's banks. Today, Mr. Chairman, the committee turns its attention to another issue that also holds out promise to reduce bank cost, and that is interstate banking and branching.

I must confess that I have some concerns about this concept which I will raise during the question and answer period, but I think there is merit in the idea that interstate banking could eliminate duplications and inefficiencies that now exist.

Now let me turn to the other issue that is before us today. I and several of my colleagues have expressed reservations regarding the District of Columbia Circuit Court of Appeals' decision that could spell the end between the traditional separation between the insurance industry and the banking industry.

Let me revisit the background on that ruling for just a moment, in case some of us have forgotten that the Chairman touched on it in his opening statement.

The National Bank Act permitted national banks to sell insurance in towns with populations of less than 5,000 persons. On first blush, it was a good idea. Selling insurance could provide extra income for rural banks that are having a difficult time. It could mean the difference between survival or having a small town with no bank at all.

However, many large national banks seized on the ruling, or the broad interpretation that was issued by then Comptroller of the Currency, Clark, and exploited what they saw as a unique and novel business opportunity.

By opening a branch bank in a small town, they could enter an entirely new line of business, one previously forbidden to them. The national banks could sell insurance not only to customers in the immediate community, but to customers nationwide, and we are speaking about general lines of insurance, including life, property and casualty, and even title insurance.

As I see it, Mr. Chairman, the first problem is as the national banks drive through this loophole, they are driving out of business many of the Nation's independent insurance agents who simply cannot compete against them.

Congress may want to look at this loophole and apply a little needle and thread to it. It has the unintended effect, I think, of tearing down the wall that has separated the banking and insurance industries for over 100 years. In its ruling, the D.C. Circuit Court of Appeals indicated that Congress could close the loophole if it wished to do so.

This morning we will be examining that, Mr. Chairman, with a view toward making a determination, and again I thank you for calling this hearing.

The CHAIRMAN. Thank you very much, Senator Sasser.

Senator Bryan.

## OPENING STATEMENT OF SENATOR RICHARD H. BRYAN

Senator BRYAN. Mr. Chairman, thank you.

Let me re-echo the sentiments of the distinguished Senator from Tennessee and commend you for holding the hearing.

These two issues that we deal with this morning are not new to the committee. We had occasion to deal, during the course of S. 543, with the interstate branching question. At that time I supported interstate branching for the reasons which have been articulated by its advocates.

I must say that I have some concern about that position. In Nevada 80 percent of the assets of banks in our State are under the control of out-of-State banks. We have recently experienced in the last year or two, notwithstanding an economy which is quite strong, a severe credit crunch based upon the decisions and policies by those banks.

Now the analogy does not escape me that indeed if these policies are set by out-of-State institutions, they can have a profound impact on the ability of small businesses in our State to be able to acquire the kind of financing they need to either establish a new

business or expand prior businesses that are trying to add new people and to move into new lines of entrepreneurial opportunity. So I do express that concern, and I want to hear some response to that.

On the second issue that deals with the bank powers issue, that, too, is an issue that has been before this committee.

I came to the committee in January 1989, as a newly elected Member to the Senate, when all of the problems of the savings and loan era, with the expansion of powers that had occurred during the preceding decade, burst upon the land and the consequences that were visited upon this country and the responsibility which this committee undertook to pick up the pieces and to continually support very unpopular pieces of legislation that was necessary to provide adequate funding to make sure that none of those depositors experienced a loss, was not, frankly, one of the most pleasant experiences that I've had back here. So I must say that I have some reluctance to embrace an expansion of bank powers.

In any event, it's my judgment that that ought to be done by an action of thoughtful review by the Congress as opposed to a regulatory approach by an administrative agency.

Mr. Chairman, I would like to ask unanimous consent that the full text of my comments be made a part of the record, and I thank you again for your leadership.

The CHAIRMAN. Very good. Thank you very much, and we will make them a part of the record.

Senator Faircloth.

## OPENING STATEMENT OF SENATOR LAUCH FAIRCLOTH

Senator FAIRCLOTH. Thank you, Mr. Chairman.

As we've talked about interstate banking and banks in the insurance business, I have three concerns.

One concern is the safety and soundness of the banking system. Banks cannot argue for unlimited freedom and still expect to receive the competitive advantage that Government guaranteed deposit insurance gives them.

While we can't allow banks to expand pell mell into any area of business they want, we also have to remember that we are competing in worldwide capital markets. While banks have to stick to banking, we have to let them be more efficient in order to hold down our own in the global economy. That's why it's time to get rid of unnecessary bank laws and regulations.

Another concern is capital taxes, regulations, and mandates. If we don't lower the cost of capital in America and lower taxes, reduce regulations and employer mandates on business in general, then the banking laws are going to be unimportant. It's literally going to be rearranging the deck chairs on the Titanic because there will not be an economy left for banks to serve unless we reduce taxes, stop increasing them, and reduce mandates on employers.

Thank you.

The CHAIRMAN. Thank you very much.

Mr. Ludwig, I know you're scheduled to testify on the House side this morning. So I want to thank you for being here. We're going to start with you, and I want you to feel free to summarize your

remarks. We'll make your full statement a part of the record, and I want you to feel free to leave as soon as you finish your statement so you can meet both commitments today.

Mr. LUDWIG. Thank you very much.

The CHAIRMAN. We're pleased to have you.

## STATEMENT OF EUGENE A. LUDWIG, COMPTROLLER OF THE CURRENCY, WASHINGTON, DC

Mr. LUDWIG. Thank you, Mr. Chairman and Members of the committee. I appreciate this opportunity to testify on insurance activities. You've invited me back to testify on interstate activities in November, and I will cover that issue then. I have a detailed written statement, and I would like to submit it for the record.

Before turning to my statement, I want to take this occasion to say a few words about you, Mr. Chairman, in light of your recent decision to retire from the Senate. Under your leadership, the Banking Committee passed more legislation—and more significant legislation—than it passed under any chairman since the Depression era. In your 4½ years as Chairman, the committee has initiated and enacted: The Financial Institutions Reform, Recovery and Enforcement Act of 1989; the FDIC Premiums Act of 1990; the Federal Deposit Insurance Corporation Improvement Act of 1991; the Anti-Money Laundering Act of 1992; the HUD Reform Act of 1989; the National Affordable Housing Act of 1990; the Housing and Community Development Act of 1992; the Federal Housing Enterprise Financial Safety and Soundness Act of 1992; the Securities Law Enforcement Remedies and Penny Stock Fraud Act of 1990; the Market Reform Act of 1990; and the Securities Act Amendments of 1990. That is quite an extraordinary list.

Further, some of the wide-ranging laws I just cited included major consumer protection legislation: Amendments strengthening the Community Reinvestment Act; amendments strengthening the Home Mortgage Disclosure Act; and provisions strengthening fair lending enforcement.

Mr. Chairman, your response to the most serious financial crisis this Nation experienced in the last 60 years reconfigured the banking landscape. The sweeping reforms you championed halted the collapse of the savings and loan industry, and reinforced the safety and soundness of its surviving institutions. Your leadership helped to strengthen our bank regulatory system at a time when hundreds of banks were failing every year, stopping and reversing the decline of the Bank Insurance Fund. At the same time, you battled discriminatory lending and fought for fairness and equality in the financial marketplace, whenever and wherever you could.

Mr. Chairman, your service and dedication to the people of this Nation will be missed.

The primary consideration in assessing any proposal for expanded bank powers for national banks is the need to maintain the safety and soundness of the national banking system. That is the central objective of bank regulation, and it will be my central objective as Comptroller.

I am glad to be able to report that the financial soundness of most national banks has improved in recent months. My written statement discusses this improvement in detail.

I want to make sure that we build upon, rather than squander, these hard-earned gains. We are taking a number of initiatives to reinforce the banking industry's recovering health and to promote the continued safety of the national banking system. For example, the OCC has increased its on-site presence in national banks and is performing annual, on-site examinations consistent with our statutory mandate.

But as we consider what else needs to be done to ensure the safety and soundness of the banking system, we need to look beyond the current favorable economic climate and recognize that the banking industry remains in a long-term secular decline relative to other sectors of the financial services marketplace. The banking industry's share of the Nation's financial assets has been shrinking for decades, and that decline accelerated sharply in the 1980's. Large amounts of deposits have flowed out of banks and into mutual funds. Lending to large corporations, formerly a mainstay of the banking business, has dropped sharply as corporations with strong credit ratings have turned to the commercial paper market as a less expensive source of short-term debt financing. U.S. banks have also lost business to finance companies, insurance companies, and foreign lenders.

Although other kinds of providers now provide an alternative source of many financial services formerly provided almost exclusively by commercial banks, banks still play a unique and important role in our economy. For the communities in which they are located, banks can serve as poles of economic development. They provide combinations of financial intermediation and payments services that are not available from any other financial service provider. They are the principal source of financing for small businesses, which are an important source of new jobs. If banks are to continue to play these essential roles and to remain financially strong, they must be given a fair opportunity to compete with other providers of financial services. Artificial distinctions between "banking" and "non-banking" products should not prevent banks from serving their markets.

The OCC has long taken the view that national banks derive the power to sell insurance from two sources: The general statutory power to engage in the business of banking and activities incidental to banking, and 12 U.S.C., section 92, which permits national banks located in places with populations of less than 5,000 to sell insurance generally as agent. The courts have recently accepted the OCC's position that a bank does not need to have a main office, but only a branch in a place of less than 5,000, in order to sell insurance under section 92; and that such sales may be made to customers anywhere.

The OCC has approved the sale of a variety of insurance products, such as municipal bond insurance and credit life insurance, under the incidental powers clause. Some circuit courts have upheld the OCC's actions and views, while two other circuit courts have ruled that no insurance activity falling outside the scope of section 92 is permissible for national banks. I believe this latter view is incorrect as a matter of law.

The sale of insurance poses very little risk to national banks, certainly less than that involved in lending. Insurance sales, like

other agency and brokerage activities, do not involve any extension of credit, because the underwriter of the insurance policy, rather than the bank, bears the underlying risk of loss.

In your letter of invitation, you asked for my views on the interstate branching and insurance powers provisions of S. 543, which the Senate passed in November 1991. As I stated earlier, I will confine my comments today to the insurance provisions of S. 543, since I will be appearing in early November to discuss interstate branching.

S. 543 would have imposed a permanent moratorium on the OCC's authority, under national banking law, to permit national banks to engage in insurance activities that are incidental to the business of banking.

In addition, S. 543 would have authorized national banks and their subsidiaries to sell insurance in any State, but only to the extent that State law permitted banks chartered by that State to sell insurance.

Finally, S. 543 would have substantially restricted the authority of national banks to sell insurance in places with populations of 5,000 or less. Sales would have been permitted only to persons residing, working, or owning property in the place. Such restrictions could make it impractical for some banks, such as those located in sparsely populated areas, to offer insurance under this provision.

I am concerned that the approach to national bank insurance powers in S. 543 may unduly limit the OCC's authority to respond to an evolving market for financial services.

No banking service is completely devoid of risk. But providing insurance services as agent or broker is about as safe an activity as can be imagined. Permitting national banks to sell a broader array of insurance products and services would not pose any material risk to the safety and soundness of individual banks, or any systemic risk to the banking system as a whole.

I thank you, Mr. Chairman, for permitting me to testify here and also meet my House commitment. I will be happy to answer questions from the Members in writing.

The CHAIRMAN. Very good.

As you leave, let me thank you for such a generous set of personal comments with respect to my work and my Chairmanship here over the last 4½ years. I am very touched by your remarks and I appreciate them. I'm very proud of the work of this committee. This committee, over that period of time, I think, as you indicated, has covered a lot of ground and a lot of landmark legislation has been enacted, all of it on a bipartisan basis. I can only recall one vote from memory over the 4½ years where we've had a party line vote, and I'm not sure there is any other committee in the Senate that can say that. But it has been true here and it's been so through some very difficult issues.

So I want to say to the Members and staff on both sides of the aisle how much I appreciate that kind of cooperation and effort because it literally is not possible to do this work any other way, in my view, and get it right.

But you were very gracious, and I'm touched by your remarks and thank you for them.

Mr. LUDWIG. Thank you, sir. Thank you very much.

The CHAIRMAN. Let me excuse you now.

Senator Dodd has arrived. Senator Dodd, would you like to make a comment now before we go to our next witness?

**OPENING COMMENTS OF SENATOR CHRISTOPHER J. DODD**

Senator DODD. Mr. Chairman, I was going to ask unanimous consent to put a statement in the record. I'm not sure you or anyone else wants to put up with this voice that I've got as a result of a bad cold, I guess, that's running around. But I just want to thank you for doing this. I've talked to you about this publicly and privately, and you've been tremendously forthcoming in scheduling this hearing and a second hearing that we'll have in a few weeks on the same subject matter. I think it's just a critically important issue and have felt so for years.

This committee has acted responsibly, in my view, in the past on dealing with interstate banking issues, and hopefully we can again. The issue, obviously of insurance, is one that this committee has grappled with in the past.

The Chairman knows of my interest, and again I think a compelling case can be made where these two issues of interstate branching and banking and the insurance question can be brought together in a way that will allow us to satisfy the needs in both areas.

So I look forward to working with you, and I'll just submit this statement for the record and ask a couple of questions.

The CHAIRMAN. Very good.

Mr. Hove, you're the Acting Chairman at the FDIC and we're pleased to have you. We'll make your full statement a part of the record and we would like to hear your comments now.

**STATEMENT OF ANDREW C. HOVE, JR., ACTING CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, DC**

Mr. HOVE. Thank you very much, Mr. Chairman, and let me also add my congratulations to you and thank you for your work on this committee. We all certainly appreciate it, and I would underscore the comments that Comptroller Ludwig had made in appreciation of your work.

The CHAIRMAN. Thank you.

Mr. HOVE. Mr. Chairman and Members of the committee, I appreciate this opportunity to testify on interstate banking and branching and the insurance activities of national banks, and specifically, on the provisions of S. 543 as passed by the Senate in 1991.

The world has changed a great deal since the constraints imposed on banking were put in place. While still an extremely important part of the U.S. economy, banks are not the dominant force they once were. Mutual funds, money market funds, securities firms, mortgage pools, pension funds, finance companies, and corporate America have all increased their shares of the Nation's financial assets at the expense of the banking industry.

The FDIC supports the relaxation of the geographic and product restraints on banks provided that the States continue to play a role in that transition. While many of these restraints had a useful pur-

pose at one time, they are becoming less relevant in today's marketplace. Moreover, the ultimate losers are consumers. They are not given the benefits of a fully competitive marketplace.

State legislatures have made interstate banking a reality to a significant degree. The Douglas Amendment allows bank holding companies to make interstate acquisitions if specifically authorized by the State in which the institution to be acquired is located. In 1975, Maine was the first State to enact such legislation. Currently, 49 States and the District of Columbia allow regional or nationwide banking.

Interstate banking offers the potential for several significant benefits: First, the diversification of assets and lending opportunities could strengthen the banking system and help to reduce costs for the Bank Insurance Fund; second, consolidation of interstate banking services could result in efficiency gains; third, increased competition could act to reduce prices and improve the quality of products and services.

Regarding diversification, the insurance funds have absorbed major losses in recent years from large banking organizations with assets concentrated in a few industries or a limited geographical area. During the 1980's, for example, slightly more than 80 percent of failed-bank assets were in just four States, Texas, Illinois, New York, and Oklahoma.

Perhaps if they had been more geographically diversified, banks in these States might have been better able to weather the financial storms that beset their local and regional energy, agricultural, and real estate markets.

Interstate banking should work to increase competition in national and local markets, particularly if banks are allowed entry through de novo branching. Consumers may benefit from higher deposit yields, lower loan rates and better quality services. Small businesses, in particular, would likely benefit because commercial banks are their primary credit source.

Some analysts have warned that newly arrived competitors less tied to local markets would channel funds to loan opportunities offering the highest yields, which may not necessarily be in the local community. Arguably, however, new market entrants would inject loanable funds into these communities, not only to respond to profitable opportunities, but to establish a local market presence.

Another issue that frequently is raised is concern about the fate of small banks in an interstate banking environment. The evidence we have seen suggests that small banks, at least those that are well managed, will not be hurt by the entry of out-of-State competitors. In States that have long-standing Statewide branching statutes, small independent banks continue to exist and often earn returns above those reported by their larger competitors.

The important role that States would continue to play under the language of S. 543 bears mentioning. S. 543 may be a good compromise between the likely savings that may occur as a result of unrestricted interstate banking and the continuation of the States' historic role in shaping the banking structures that serve their citizens.

States could apparently elect not to permit in-State banks controlled by out-of-State bank holding companies to be converted to

branches. Moreover, de novo interstate branching could take place only if explicitly authorized by a State.

In this regard, S. 543 would ensure that the States have the same control over interstate branching they now have over the interstate expansion of bank holding companies under the Douglas Amendment. Finally, State-chartered banks would still be subject to State bank supervisors.

In sum, the FDIC believes that interstate banking is both desirable and inevitable and will work to the benefit of users of banking services. Moreover, interstate banking does not raise safety and soundness concerns, but in fact may strengthen the banking system.

You also asked that we address the insurance activities of national banks. Insurance agency and brokerage activities, the selling of insurance, appear, if conducted properly, to pose few safety and soundness dangers for banks. Consequently, the FDIC believes that banking participation in insurance agency and brokerage activities is appropriate, and indeed further participation would benefit consumers by increasing competition.

Consequently, because S. 543 would likely restrict, rather than expand, the insurance agency and brokerage powers of national banks, the FDIC does not favor the legislation's approach to bank insurance powers.

Agency and brokerage activities, however, should be distinguished from underwriting activities, which may entail the possibility of significant losses. In the absence of an effective separation between insurance underwriting activities and Government-insured funds, the FDIC would not support the expansion of banking organization involvement in insurance underwriting activities.

In conclusion, the FDIC supports the relaxation of restrictions on interstate banking and on bank insurance agency and brokerage activities. The banking industry needs the freedom to compete in today's financial marketplace.

Moreover, greater interstate banking and insurance powers, if properly implemented and supervised, could serve to strengthen the banking system and therefore reduce the risks to the Bank Insurance Fund.

I appreciate the opportunity to testify today, and look forward to questions.

The CHAIRMAN. Very good. Thank you.

Governor LaWare, you're here in your capacity representing the Federal Reserve System. We're pleased to have you back before us again, and we would like to hear from you now. We will make your full statement a part of the record.

## STATEMENT OF JOHN P. LAWARE, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WASHINGTON, DC

Governor LAWARE. Thank you, Mr. Chairman.

As you know, I've already expressed to you personally the Board's feeling about the contribution that you've made over the years and how much we will miss you in your present capacity.

The CHAIRMAN. Thank you.

Governor LAWARE. I'm here on behalf of the Federal Reserve Board to discuss the interstate banking and insurance provisions of S. 543 as approved by the Senate in 1991.

For many years the Board has believed that full interstate banking would benefit bank customers and lead to a stronger and safer banking system. Similarly, the Board has long been on record in support of legislation to update the Nation's banking statutes to allow banks to adapt to changes in the financial services marketplace and to better serve customers and consumers.

In this context we have consistently supported the provision of insurance activities by banks and bank holding companies. Although interstate banking is to a large extent a reality today, the Board believes that there is need for Congressional action because providing more uniform rules for interstate banking and the authorization of interstate branching would provide several public benefits.

First, reducing obsolete barriers to entry would, through increased actual and potential competition, benefit bank customers through lower prices for credit, higher rates on their deposits, and improved quality and easier access to banking and related services, particularly for 60 million of our citizens who live in areas where State borders intersect.

Second, greater opportunities for geographic diversification would permit institutions to cushion losses in one region with earnings in another, making banks better able to contribute to the recovery of their local economies.

Clearly, greater geographic diversification would have provided more stability over the last decade to banks operating in the agricultural areas of the Midwest, the oil patch of the Southwest, and the high-tech and defense regions of New England and California.

Third, interstate banking would facilitate the allocation of resources to regions that offer both safety and higher returns and would assist in the reduction of excess banking capacity.

S. 543 would authorize interstate banking on a nationwide basis through the acquisition of existing banks 1 year after enactment, and it would permit interstate banking offices to be converted to branches.

The Board strongly supports such statutory change and would recommend that the Congress authorize the interstate acquisition as well of de novo banks. The Board also supports removing entirely the McFadden Act's restrictions on interstate branching for national State member banks rather than taking the intermediate step of requiring the States to authorize branching outside of the holding company structure.

In addition to permitting banks to choose between alternative combinations of subsidiary banks and branches in the manner that best balances their own perceived costs and benefits, such a change would avoid placing independent banks at a competitive disadvantage in branching against banks that are in holding companies.

I should note that the Board supports permitting foreign banks to establish and operate interstate branches on the same terms and conditions as applied to national and State banks, and it believes that the provisions of S. 543 that prohibit foreign banks from opening new interstate branches, except through an insured subsidiary

bank, are not consistent with the principle of national treatment and should be reviewed.

The Board agrees with the bill's approach of extending interstate branching powers only to those banks that are at least adequately capitalized and adequately managed, which we assume means having an acceptable supervisory rating.

A policy that rewards stronger banks is a desirable supplement to the regulatory limits imposed on weaker banks. The bill's provisions authorizing the regulators to approve interstate combinations to improve the financial condition of critically undercapitalized bank holding companies is also desirable.

Interstate branching does raise thorny problems of supervision and powers. So long as safety and soundness is not compromised, efficiency and least cost are the important factors to consider in addressing supervisory issues. And we support the solution proposed in S. 543 which would have the States negotiate supervisory agreements acceptable to both States and to the relevant primary Federal regulator. Failure to reach agreement would require the primary Federal supervisor to conduct examinations without deferring to the State authorities.

The issue of the powers that interstate branches should be permitted to exercise requires balancing a number of competing concerns, including preserving the dual banking system and creating incentives that could make certain types of bank charters more attractive than others.

We read the Senate bill as attempting to balance by providing that interstate branches of State-chartered banks may not engage in any activities in the host State that are not permitted for banks chartered by the host State, while national banks would retain the same powers in all States.

Under the bill, out-of-State branches of national banks would be subject to the same State laws governing intrastate branching, consumer protection, fair lending, and community reinvestment as applied to national banks headquartered in that State.

One concern about interstate banking is that it would lead to excessive concentration in local banking markets. As indicated by Appendix Table B–7 to my formal statement, concentration ratios have not increased in local markets despite the substantial overall consolidation of banking in recent years.

Attempts to increase competition through imposing Statewide or national deposit caps, such as those included in S. 543, are unnecessary at best and may in fact be anticompetitive to the extent that they prohibit entry.

Another concern of some is that new entrants will vacuum up local deposits and channel them to out-of-State loans, or that managers brought into local markets will be insensitive to or have no authority to adjust to local demands.

In addition to the need to meet Community Reinvestment Act responsibilities, out-of-State entrants will face competitive pressures created by ease of entry and will ignore local customers at their peril. In this context, the Board sees no need for the provisions of S. 543, which would require the promulgation of regulations prohibiting the establishment of branches solely for the purpose of deposit production.

However, because the Board realizes that the expansion of nationwide banking raises a number of issues regarding the impact on local community needs, it supports provisions of S. 543 which would amend CRA to require that performance of interstate institutions be assessed on a Statewide or metropolitan area basis. This approach would maintain the concept embodied in CRA that ensured banks should be evaluated on overall performance without imposing arbitrary or costly regulatory requirements at the level of the individual branch.

The committee has also requested the Board's views of the insurance provisions included in S. 543. The Board has consistently supported the provision of insurance agency activities by banks and bank holding companies and believes that increased bank participation will enhance competition and improve customer convenience without adversely affecting safety and soundness. Thus, the Board sees no argument on either competitive or risk management grounds to retain or impose limitations on insurance agency activity. A number of States already permit their State-chartered banks to engage in insurance agency activities.

The Board supports the bill's provisions to amend the National Banking Act to authorize national banks to conduct insurance activities to the same degree permitted for State banks in those States.

However, the Board opposes the proposed limitations on existing authority to conduct insurance agency activities outside the State in which the bank is headquartered and the limitations on insurance activities in small towns.

It is also the position of the Board that insurance underwriting activities should be authorized for banking institutions so long as the activities are conducted in a separate holding company subsidiary.

In sum, the Board believes the interstate banking and branching and broader insurance authority would provide wider household and business choices at better prices. These needed reforms would also strengthen our Nation's banking system by increasing competitive efficiency, eliminating unnecessary costs associated with the delivery of services, and encouraging the reduction of risk through geographic and product diversification.

Mr. Chairman, that completes my summary, and I would be happy to answer any questions.

The CHAIRMAN. All right. Let me start out this way, and this is a question to both of you, and that is how, if at all, do you think interstate banking of the kind we're talking about here would affect the safety and soundness of the banking system? I realize this goes back over some of the things you've said, but I would like just a crisp answer to that by each of you.

Mr. Hove or Mr. LaWare, either one.

Governor LAWARE. By broadening the branch reach of an individual institution you clearly offer both geographic and customer diversification so that credit risks that might arise regionally can be at least partially offset by credit opportunities in another area that is less affected by an economic cycle.

The CHAIRMAN. So the net of that, in your view, is that you think safety and soundness would be enhanced?

Governor LaWare. Yes, sir.

The Chairman. Mr. Hove.

Mr. Hove. I would agree with that. The example that I can point to is, as we've seen bank failures move from one region to another, the regions have not, in many cases, had the benefit of diversification of their deposit or their loan risk in areas outside of their region. It seems to me that that kind of diversification of risk, in both the loan portfolio and their deposits, would be to the advantage of the bank insurance system.

The Chairman. Now, as we move toward full interstate banking, I'm asking both of you, what kind of safeguards do you think need to be put in place to ensure against an undue concentration in the banking system?

Mr. Hove. I would suggest that the percentage concentrations that have been suggested are perhaps the best approach and maybe the percentage concentrations in each State or in each region need to be further refined.

Governor LaWare. I'm not sure that I agree with that. In my view, the creation of rigid kinds of constraints on concentration are really not necessary at this stage of the game. As we progress—if indeed the industry were to be significantly further concentrated—then it might be appropriate to enact some legislation, but I don't see enough of a threat to require anything specific at this point in time.

The Chairman. Do you think any protections are needed to protect local decentralized banking operations so that they don't just get wiped out?

Governor LaWare. Experience has shown that that just doesn't happen. California is a perfect example. I think there are well over 300 individual independent banks in California today in spite of the fact that California has had Statewide branching since 1927 or 1928, and, of course, Bank of America and others there have Statewide branch systems that are huge, and yet they haven't squeezed out the smaller- and medium-sized banks at all. In many cases the smaller- and medium-sized ones have thrived in spite of the competition from the big guys.

The Chairman. Let me ask you this, Comptroller General—yes.

Senator Mack. Mr. Chairman, if you wouldn't mind, let me just ask——

The Chairman. Sure.

Senator Mack. Would you make that statement universal throughout the country? I mean, for example, is Florida's situation similar to California's? I'm under the impression that there are four institutions in our State that control maybe 75 percent of the deposits.

Governor LaWare. That may well be, but I'm sure that there are still dozens of small independent banks in Florida that are doing quite well. They are not just being squeezed out by the big guys.

The extent of concentration doesn't necessarily preclude opportunity for smaller institutions either to start up or to thrive once they are in place. Experience has shown that, I think, since 1980 over 5,000 banks have gone out of existence through mergers or acquisitions as independents by bank holding companies, and over

that same period of time roughly 3,400 new ones have been chartered.

So the perception of entrepreneurs is that there still remains large opportunity in spite of concentrations of large institutions. There are very few metropolitan statistical areas in the United States where the concentration levels are high enough to even concern the Attorney General.

New York, for example, one thinks of New York as being dominated by four or five huge banks, and yet the merger of Chemical and Manufacturers a year and a half ago didn't even jiggle the charts as far as being concerned about concentration.

The CHAIRMAN. Mr. Hove, I would like your answer on the record, too, please.

Mr. HOVE. I agree with what Governor LaWare has said, that the survival of independent banks really is more dependent on the good management of the independent banks. In California and Florida there still are very good independent banks.

There are some problems in California that have been clearly identified. However, there still are some very good smaller independent banks in California that are very profitable and surviving right alongside some of the larger ones. The same thing is true in your State Florida.

Senator MACK. Thank you.

The CHAIRMAN. Let me just ask one other question. In 1991 Comptroller General Bowsher urged this committee not to let weak banks expand through interstate mergers. He stated:

> We should not permit through interstate mergers the creation of weakly capitalized, poorly managed large banking organizations.

Would you agree with Mr. Bowsher on that point?

Governor LAWARE. Yes, sir, particularly on the latter part of his statement, and I think in my testimony I touched on the fact that to permit a weaker bank to engage in a merger interstate that would strengthen it in terms of its capital structure and its safe and sound operation is highly desirable. But we would certainly not be a party to a merger that would result in a weaker institution.

Mr. HOVE. I agree totally. You know, if the merger makes sense to improve the capital situation of a weak institution that can be merged into a stronger institution, fine. But we certainly don't want to create a situation where we're putting two weak ones together in some attempt to make an institution that's going to continue to be weak.

The CHAIRMAN. Very good.

Senator Mack.

Senator MACK. I just have one other area to touch on since I had the opportunity to explore that question a moment ago, and that is, again I go back to my own State, and maybe it's drawn on the experience of the last 2 or 3 years. We've had a lot of concern from a host of business men and women around the State about credit availability, and it initially started out as being a real estate oriented kind of situation. But over a period of time I heard from more and more business types about their inability to get credit.

The background there is to raise the question that with four institutions controlling 75 percent or so of the deposits in a State, that, in essence, means that basically four people can get up one

morning and decide there is a certain type of loan that they don't want to make any more. That has a rather significant impact throughout the State as compared to if you have a larger number of smaller institutions, community-based institutions trying to make decisions about lending policies for their communities.

It seems to me that that's a fairly sound and reasonable approach, the point being that I'm beginning to have concerns about fewer and fewer people making decisions about larger and larger pools of funds, as to how they're going to be used, what kind of loans are going to be made, where they're going to be made, and under what conditions they're going to be made, as opposed to maybe hundreds of decisions being made. Give me a reaction to that.

Governor LaWare. Obviously, the availability of an alternative source of any service, whether it be a credit service or whatever, is highly desirable and improves the competitive atmosphere.

On the other hand, I would point out that even though it's four institutions, their life blood is making loans, and any bank or any institution who refuses to meet the credit needs of its customers is not going to last very long because the customers are going to find some other way to satisfy those needs.

Now, those four institutions are in competition with each other, and I would judge that if they saw one of their members withdrawing from some market where they thought there remained credit opportunities, one of the other three would jump into that and try to get that share of a good market. That's from 35 years of being involved in the banking industry, and that's the way I've always viewed it.

Senator Mack. I must say I have many of the same views. I mean, that has been my general approach to this, particularly the comment that you made earlier that there always will be a market for the small independent bank. There are going to be those niches out there that the larger companies, for whatever reason, have decided not to involve themselves in. But when I look at things on a day-to-day basis in my State I must say to you that I have these concerns being raised in my mind as to whether that in fact really is taking place.

Governor LaWare. Let me try to give my view of some of the reasons why some of those people may be having difficulty getting credit. The banks have been through a very traumatic period. First of all, a down cycle in the economy aggravated by a collapse in commercial real estate, which caused a lot of these banks to lose significant amounts of money, and almost at the same time when they were trying to deal with that kind of trauma we were imposing new higher capital standards on them.

So, many banks not only were rethinking credit policies and procedures in order to avoid making similar mistakes in the future, but they were also trying to build their capital account and the capital ratios in their system.

One way you do that is to either make the standards by which you make loans so strict that your loan account ceases to grow and in fact may even shrink so that the capital ratios are readdressed or you go out to the market and you try to acquire more capital.

In that kind of an atmosphere it is going to be more difficult for some potential borrowers to get credit.

The second part of that, or the other side of the coin I guess you would say, is that during the business cycle that we had in 1990, 1991, and 1992 a lot of these borrowers were severely hurt themselves so that their balance sheets and their profit and loss statements didn't look as lendable at the end of the cycle as they may have in the mid-1980's when everything was a boom time.

And, finally, I would simply say that the bankers continue to maintain that the lack of growth in new credit in the banking system is more a function of slack demand than it has been an unwillingness to lend. That's their testimony.

Senator MACK. Mr. Hove, do you want to comment?

Mr. HOVE. I would follow up with what Governor LaWare said, that the banking industry has undergone a good deal of trauma as have borrowers. However, in our most recent quarter that we have now looked at, our bank performance results indicate that now we're starting to see some loan growth.

So I think that the recovery is starting and loans are starting to grow in the banking industry, which I think will have an effect in your State like other States. You'll start seeing some loan demand picking up simply because the economy is improving and simply because the attitude of both borrowers and bankers is getting better and more positive toward new loans and the ability to pay them back.

Senator MACK. Let me just pursue this a little bit further. Is there any point at which you become concerned that there are not enough people involved in that decision-making about what loans to make and where to lend the money? Suppose it was just two institutions, would that concern you?

And, second, it seems to me that part of your response or a reaction to part of your response would be that in the long term I think your answer is correct, but I also have some concerns about the short term, the ability of the market to really respond to a decision, one morning four people deciding, gee, let's just not make any more real estate loans.

Eventually somebody will figure out a way to create a new product to provide that service, but in that interim you could have a rather significant effect, in a broad sense, on the economy let's say of a given State, but rather significantly on individual companies, developers and real estate people, and so forth.

Governor LAWARE. As a matter of fact, we look at many applications for mergers or acquisition of another bank, particularly in a small market or an isolated market where the nearest alternatives may be 20 miles away, as being a matter of grave concern. I personally have voted against some of these mergers and acquisitions because I felt that we were getting too much concentration in a relatively small market, or that the ease of entry of a new competitor into that market was not sufficient to make it attractive and to get in there and compete with the dominant factor.

But to put a precise numerical value on what that threshold should be is very difficult. It almost requires individual judgment case by case, and that's the way we try to approach it.

Senator MACK. I can understand that, and I appreciate those comments.

Thank you, Mr. Chairman.

The CHAIRMAN. Very good.

Senator Murray has had to leave to go to the floor. She has asked me to submit a question in her name to you, Governor LaWare. So I will do that and ask you to respond for the record.

Senator Sasser, I think you're next in line.

Senator SASSER. Thank you, Mr. Chairman.

Mr. LaWare, we read the disheartening news in the Wall Street Journal this morning that the number of our fellow citizens that fell below the poverty line in 1992 increased by two million. We now have 37,400,000 people in this country living below the poverty line.

We have seen, over the past decade or longer, really what I would characterize as a series of rolling recessions; that is, prosperity and growth in some areas of the country and recession in others.

I am wondering what you see as the impact of interstate banking on this tendency to have areas in recession while other areas are in relative prosperity or growth. Would interstate banking tend to bring capital into the areas which are in recession, or is it going to cause a flight of capital out of those areas into the growth areas and exacerbate economic problems in those areas that are in recession?

Governor LAWARE. It's hard to generalize, Senator. Let's look, for example, at the crisis in the farm sector in the mid-1980's. Many of the banks that were most seriously affected were banks that were a captive of a unit market. In other words, when agricultural land values went down dramatically the farmers were in trouble in terms of paying off their loans. When they were in trouble the supermarket and the gas station and the drug store also got in trouble and they were all customers of the same bank.

Now I'm not suggesting that all small banks ought to be parts of big unit banks with branches. But if the system had been more integrated most of those banks would not have failed. They would have been able to ride out the storm with their customers, help those customers get through the tough period because they would have had adequate capital from their parent somewhere else in order to do that.

I think that the existence of diversified systems that might experience what you call a rolling recession in one area of their market but thrive in another area of their market tend to even out the problem and tend to cushion the effects on the local situation.

In terms of capital flows it's difficult because capital tends to seek opportunities, and when you are in a deep recession it's sometimes hard to find those opportunities unless you have the entrepreneurial skill to pick the one that you think is going to be on the turn. But certainly the availability of capital in large amounts from one part of an organization to another and the mobility of it is clearly there.

Senator SASSER. Let me ask this question of Mr. Hove. I have been concerned for some time, as you may know, about the concept of "too big to fail." We have seen that doctrine followed by the

FDIC, and I suppose the Fed, over the decade of the 1980's, and I have felt that what you have in that situation is private enterprise in a market system for the smaller banks and an economic socialism for those banks that are "too big to fail." The FDIC and the Fed are going to move in when they get in trouble because they say they just can't allow these banks to fail.

If we move into interstate banking, what is your view about further consolidation of financial resources into large institutions, thereby producing more banks that are "too big to fail." Would we be enlarging on that concept? It appears to me we might be.

Mr. HOVE. We've got some real concerns about "too big to fail," and it has happened in a few instances in the last decade. In those times it was determined, for a variety of reasons, that an institution that we would let fail would cause ripple effects in the economy that would be disastrous. And, therefore, in about five or six instances, the FDIC Board determined that the institution was "too big to fail."

Senator SASSER. Yes, I understand the rationale behind it, but doesn't this enlarge that concept?

Mr. HOVE. It may. However, some of the safety valves put into place, the prompt corrective action, and the capital standards that limit the activities that they can do as capital drops down, I think will minimize some of that. However, we still have some concerns about "too big to fail."

The other issue is that it is tougher for us now to make a determination of "too big to fail" than it has been in the past and it could cause problems. However, I think that the safety valves that you put into the system will tend to minimize the problem.

Senator SASSER. All right. I don't have any further questions.

The Chairman has left and I suppose Senator Roth is next.

Senator ROTH. Thank you, Mr. Acting Chairman.

[Laughter.]

Gentlemen, I would address these questions to both of you. One of the concerns regarding interstate banking and branching is the potential impact on State revenues. Do you believe that interstate banking and branching proposals can operate in a revenue neutral manner for each State budget, and let me give you an example.

If you have two subsidiaries of a single bank holding company operating in two States, would the conversion of these subsidies into branches affect either State's ability to lay claim to the income of the other State's operation?

Mr. HOVE. I believe that is why we would argue that the provision to leave a decision to the States as to whether that State wants to make a determination to opt in is very important, because it allows the State to make that decision as to what we want to do in our State, in the State of Delaware or Tennessee or wherever.

I think that's important and that's why I would argue that the opportunity for States to determine whether they want interstate branching is solely the decision of that State. In making that determination, they can then make the decision and determination as to the tax implications that they would have.

Senator ROTH. So they should opt in rather than have the right to opt out?

Mr. HOVE. I would argue for opt in.

Senator ROTH. Governor.

Governor LAWARE. Senator, you really catch me off base when it comes to tax law because I'm not a student of tax law. But it seems to me that there must be other businesses that have branches that cross State lines, and it would seem to me that the tax implications, or the tax precedents set by the way those kinds of businesses are treated, would apply to banks as well as to let's say a drug store chain or something of that sort.

I just don't know what the law is in that respect, but it would seem to me that, whatever the law has been, it is within the power of Congress or the States or the two acting jointly, to provide for the revenue neutrality of this kind of a change.

Senator ROTH. I gather, Mr. Hove, from your answer, you say it will impact income and that's the reason they should have that option?

Mr. HOVE. I don't know that it will impact, but that's why I would say that it's a decision that the State legislature needs to make as to their own determination of whether it's going to impact their revenue or not.

I'm not familiar with the taxing of States and how they tax banks. If, in fact, they tax capital in some way, it could affect it, but I don't know that, and that's why I think it's important for the State to make its own decision.

Senator ROTH. Let me go on. As a policy matter, how should the relative banking powers of the States be handled with respect to the powers of the parent company in the home State vis-a-vis the powers of the branch back in the host State? In other words, could a bank based in a home State be authorized to do more through its branch in a host State than it could do in the home State?

Governor LAWARE. You have division here in Federal law. The national banks have certain rights that are independent of the State laws for the State in which they operate, and the most notable exception is that they must comply with State law with regard to branching.

Let me explain the State side of it. With regard to the States, the State-chartered banks would have to operate according to the provisions of this bill under the laws of the host State. So that if you were headquartered in Ohio and you had a branch in Indiana, the branch in Indiana would have to operate under the State laws of Indiana and not those of Ohio, and I think that's a desirable provision.

Senator ROTH. How about you, Mr. Hove?

Mr. HOVE. I agree with that.

Senator ROTH. Let me ask you this. The language of the Dodd bill, S. 371, seems to give priority, with respect to consumer protection and fair lending laws, to the State law of the customer or branch bank as opposed to the law of the home State where a bank is situated.

I wonder if this priority is consistent with the Supreme Court decision in the Marquette case, or would the proposed legislation seem to reverse Marquette?

Governor LAWARE. You've got me.

[Laughter.]

Senator ROTH. Mr. Hove.

Mr. HOVE. I'm not familiar with the Marquette case.

[Laughter.]

Governor LAWARE. Let me respond in writing to that question, Senator.

Senator ROTH. All right. Well, we would appreciate having that.

Let me then ask you another question. When a bank in State "A" sells an insurance product to a customer in State "B" would the bank and the product both be licensed by the insurance authorities in State "B" under this legislation?

Governor LAWARE. I think that in order, if I understand it——

Senator ROTH. I'm asking under current practice.

Governor LAWARE. I think under current practice of an insurance company, the underwriter has to be licensed in the State in which the policyholder is going to be holding the policy. In other words, they have to meet the insurance requirements of that State in order to be eligible to sell a policy to a citizen of that State regardless of from whence it is sold, and I would presume that that would continue to apply.

The question really relates to the limitation on whether a branch or a bank operating in one of these small communities can sell anywhere, and that's a consideration for the Congress, in my opinion.

Senator ROTH. Mr. Hove.

Mr. HOVE. It's our understanding that the bank, in order to sell insurance to residents of another State, needs to be licensed in that State, but they have the ability to sell to residents of that State.

Senator ROTH. And, finally, I would gather that out-of-State insurance sales are done normally by mail. In mail transactions of this sort—basically "cold calls"—is there much danger of the bank tying the insurance product to a bank product?

Governor LAWARE. I don't believe so. Tying is illegal for banks for one thing, and I think any bank that even flirted with a violation of that sort would be very ill advised. It is a serious violation and one that most banks assiduously try to avoid. There are very few cases where there is even a suspicion of tying going on.

Mr. HOVE. And it would seem to me that a mail solicitation would clearly not have any implication of tying.

Senator ROTH. Well, I see I'm the entire committee.

[Laughter.]

I see where there is a vote. So the committee will be in recess subject to the call of the Chairman.

Thank you, gentlemen.

Governor LAWARE. Do you wish us to wait?

Senator ROTH. Yes. There will be further questions by other Senators.

[Recess taken from 11:31 a.m. to 11:36 a.m. awaiting Members' return from voting.]

The CHAIRMAN. The committee will come to order.

Let me give everybody an opportunity to get seated and get situated, and let me now call on Senator Dodd.

Senator DODD. Well thank you very much, Mr. Chairman.

I apologize to our witnesses and to the other Members of the committee that I have this cold that everyone seems to be catching here in Washington. So, I'll be brief and with your permission, Mr. Chairman, submit my statement for the record.

First of all, let me commend you both on your comments about the interstate banking proposals. I, as you know, am in full agreement with you on it.

Of course coming from the New England States the arguments about what some alternative capital resources could have meant to a number of our institutions speaks for itself. And although we had the New England Compact, in a sense I blame myself a bit for having been one of the authors of this regional banking proposal a number of years ago.

When we started fooling around with this, we thought that regional compacts would give way to full interstate banking in a few years. Instead, because of a storm of controversy, full interstate banking and branching has been delayed. The indefinite delay caused a number of banks to perceive that they had a brief window of opportunity. It was almost like some of these institutions were taking steroids, trying to build themselves up to a point where they were not capable of handling it.

Had there been a more deliberate growth, I think we would have avoided the problems we've seen. I think we encouraged that kind of growth by suggesting somehow, that these regional compacts would only exist for a very short period of time.

Having said that though, I really do believe, and again I'm just repeating what you and others have said, that for this country to enter the 21st Century with a banking structure the way it is presently fashioned is dangerous. We've got to get beyond that very quickly. I'm confident that can be done.

This committee and the Senate has dealt with these issues in the past and we've had trouble in resolving the interstate and insurance issues. But, the issues aren't going away.

The history of the insurance issue goes back to 1916 when we created this town of 5,000 exception to help bolster the financial viability of small town banks by permitting them to sell insurance within the town. The Comptroller, at the time, and I quote him, stated:

> It would be unwise and therefore undesirable to confer this privilege generally upon banks in large cities where the legitimate business of banking affords ample scope for the energies of trained and expert bankers.

Over the years, we've watched this exception expand to the point where recent court decisions have permitted national banks to use small town offices as a launching pad for nationwide sales of insurance. We've reached an absurd point where we have financial regulation by loophole.

Without Congressional action, the regulators and the courts have made a major policy decision by expanding a small loophole far beyond its original scope and intent. Even if you agree with the ultimate result of this policy, you have to believe that it doesn't make any sense to accomplish it in this manner.

I think that it is revealing that the recent D.C. Circuit Court decision invited the Congress to clarify this area stating that, and I quote:

> When time and technology open up a loophole, it's up to Congress to decide whether it should be plugged and how.

We have spoken here in this body on that issue in the past and have advocated plugging it up rather than expanding it. Now we

have failed to get legislation passed, but there seems to be a pretty strong desire on the part of Congress in that area still to plug up that loophole.

So how do you respond to the absurdity of this situation where I make the point, or if you disagree with it, as I presume you may, of regulation by loophole in effect?

Governor LaWare. I agree that this is a loophole in the sense of being able to sell anywhere from a town of less than 5,000 people. Of course, if that got to be a big enough operation, maybe it wouldn't be a town of 5,000 people any more.

[Laughter.]

Senator Dodd. Then they would have to stop selling.

[Laughter.]

Redistricting is a new dimension.

Governor LaWare. I happen to be a believer in the idea, or the concept of integrated financial services. Aside from the possibility of common ownership between banks and insurance companies, which is now permitted commonly in Europe, is now permitted in Canada, and it seems to be a spreading phenomena around the world, it seems to me that the use of banks to help distribute insurance at lower cost to consumers is a desirable public benefit.

What kinds of boundaries are appropriate to put around that capacity is another matter. At one end of the spectrum would be an unlimited marketplace where it could be sold by mail, and another would be that it could only be sold through branches, or the main office of banks, to their own customers rather than just broadcast.

Somewhere in that range, it seems to me, would be a reasonable restraint, and at the same time offer the consumer advantages of perhaps being able to purchase all kinds of general insurance at lower premiums because the large commission for the agent, which is a major part of at least the first year's premium, for example, on a life insurance policy, could be substantially cut because of the more efficient way of distributing it.

Senator Dodd. Mr. Hove.

Mr. Hove. I agree with what Governor LaWare has said as far as the restrictions that you would put on it. I agree with you that it doesn't make a lot of sense to have an arbitrary restriction at 5,000 people. However, at the same time, it seems that we are looking at a banking industry that is declining in its role in the financial services industry. It seems to me that you might want to look at expanding that for some of the reasons that Governor LaWare has stated. There are reasons why a bank should be able to offer all of its financial services to its customers regardless of whether its customers are located in its local community or outside its local community because deposit accounts and loan accounts aren't necessarily all located in a local geographic area.

Senator Dodd. I appreciate that those are arguments that are made. I introduced, a few years ago, something that Bob Lighten advocated, and that is the narrow bank concept, which is along the lines that you suggested to permit some of these activities.

You could make a case, however, that permitting one stop shopping where you have a captive audience can also have negative consequences, which is the other side of the argument. We've seen that in the past, where a bank's willingness to accept a certain cus-

tomer is contingent upon their willingness to accept other instruments, can create a situation that is not exactly the most desirable for people.

So I appreciate the argument on this side, and I think we're moving in a certain direction, and clearly that has been reflected in the votes that have occurred here.

In a sense, I'll be very honest with you as well. I'm looking for a formula here, too, quite honestly, that will allow us to achieve some desirable results between the banking community and other financial services. We've been stymied in the past, and I'm trying to see if we can't put together some sort of a combination here that will allow us to achieve some desirable results, even though there may be aspects of this that raise certain questions in people's minds.

I would suggest, in the absence of doing that, that I think we're engaging in a wonderful discussion and dialog here, but it's not going to go any further than this, as my experience has been.

I've talked with some people, over the last week or so, about this privately, and urged them to consider the possibility of some compromises in this area so that we might achieve some larger goals that I think are extremely worthwhile.

So, for those of you who are testifying here, and those who are in the audience that will be following this debate, there is a larger issue here than just the details of what we're talking about and I would urge them to consider that as we try and fashion some legislation that has a chance of becoming law. Even though it may not be exactly what everyone would prefer, it may be a hell of a lot better than what we're presently looking at.

So with that, Mr. Chairman, I again thank you for having this hearing this morning.

The CHAIRMAN. Thank you, Senator Dodd.

Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman.

I want to follow up on the line of colloquy that the two of you were having with Senator Mack. You will recall he expressed some concerns about the concentration in his own State. His State, if recollection serves me correctly, probably has somewhere in the neighborhood of 9 million people, and he said his concern was that there were four banks that in effect had, I believe it was 75 or 80 percent.

Well, my concern is somewhat similar. Our State is nowhere near as large as Florida. We have about 1,400,000 people, but in our State it's not four banks, it's two banks that have about 80 percent of the deposit base, and they are not primarily Nevada institutions, and the lending decisions are primarily made outside of the State.

Although, as Governor LaWare pointed out, and it is true, small banks have come in and have prospered and done well, because of the inherent lending limits that they have because of their size, when the two large institutions withdrew from the market, no place in the country had a more precipitous decline, in terms of commercial lending, than we did in Nevada. We declined by 30 percent. So the small banks, although they found a niche in the market, as you're indicating, certainly could not fill the gap. And I

guess my question to the two of you is, doesn't a State have a legitimate concern about that kind of concentration?

Governor LaWare.

Governor LAWARE. You had raised this question before, a couple of weeks ago when I was here.

Senator BRYAN. Yes, I did, sir.

Governor LAWARE. And we have been trying to look into the phenomena that you cite of a 30-year 35 percent drop in lending——

Senator BRYAN. Commercial lending.

Governor LAWARE. Commercial lending, as to whether that is a distortion of the figure due to the fact that the parent organization may be booking those loans elsewhere. They may be originating in Nevada, but being booked in the home State of the bank holding company that controls that bank. We haven't been able to get the answer yet, but it's something that we have been trying to root out for you.

If, on the other hand, it truly represents a shrinkage of 35 percent in commercial lending, that would be out of the pattern that has been elsewhere in the country. I mean that's a precipitous drop in commercial lending, and again it is difficult to track it down as to whether that's a demand function or a supply function, but we're working on it and we're trying to get it for you.

Senator BRYAN. Well, I appreciate it, and I want to give you time to look at the database. I suspect that you're not going to find that those were booked elsewhere. But I'm asking the broader question, isn't that a legitimate concern?

Assume, for the sake of argument, there has been that kind of a decline, and maybe, Mr. Hove, this will give you a chance as Governor LaWare and I had a chance, to at least converse briefly about this the other day, I mean you're in effect saying, or Governor LaWare makes the point to quote, "lending is the life blood of the bank."

There are a lot of people in our State, business people, not people who have been historically critics of banks, and I'm not talking about consumer activists who can find a number of areas that they have some fundamental policy disagreements with. These are people that are part of the business community, that have historically been strong defenders and business associates and colleagues of banks, who would reject that premise and the ones who would say, look, the primary purpose appears to be in the 1990's for banks to invest in Government securities and not to be involved in lending, their historical and their very needed function.

Let me ask you, Mr. Hove, what your response would be in terms of a State's legitimate concern about the concentration of that kind of power with institutions that, in effect, are headquartered outside of the State and may not be as attuned to the local needs.

Mr. HOVE. I had mentioned earlier that you may want to look at some concentration limits. On that point, I think Governor LaWare indicated some disagreement with my position. But I think that it's an issue that clearly bears looking at, not only concentrations on a national level or a regional level, but maybe even on a State level, to determine what is the level of concentration of two holding companies. In your case, two holding companies have 80

percent or more of the deposit base in your State. I don't know what the number is, but it may be something worth looking at.

Senator BRYAN. My question was a broader philosophical one, and you're right, maybe we need to do that. I'm one who has supported interstate branching legislation in the past. So I don't come as a historical critic.

Let me ask you on the insurance issue to change the function a little bit. Traditionally, most insurance activity has been regulated at the State level, and what is your response to a suggestion that a determination as to whether or not banks should be permitted to sell insurance, to make that in effect a function to be determined at the State level.

For example, the State Legislature in my own State recently approved in the last legislative session, the sale of annuities by banks. What would your response be to that kind of an approach as opposed to some type of preemptive Federal approach or an incremental regulatory approach, which I've expressed some concerns with?

Governor LAWARE. I think the exercise of the State's rights in a situation like this is appropriate inasmuch as there is no present Federal regulatory body for governing the insurance industry.

I think that a concern that anybody has about some of these products is well illustrated by annuities and the importance of the consumer being made aware that this is not an insured bank product, but is rather a product in which a consumer is at risk with the issuing company, rather than being insured by or protected by Federal insurance of any kind. But I think State authorization is quite appropriate in this instance.

Senator BRYAN. As opposed to a Federal approach that would seek to impose some type of a comprehensive standard or policy?

Governor LAWARE. I guess to some extent I'm a State's rightist. I think that the States have used good judgment, for the most part, in evolving the banking system. It is purely, up until this point, a function of State legislation that we have interstate banking at all, and it has come gradually enough so that I think some of the dangers of too rapid a change have been avoided.

Now, having said that, I have to confess that for a long time I kind of chaffed under the fact that we could not get Congress' attention to doing something about interstate banking on a national basis, but as it turned out I think the result has been very worthwhile.

Senator BRYAN. Mr. Hove, your response.

Mr. HOVE. I agree again with what Governor LaWare had indicated. We are primarily interested in State banks. We are very interested in the ability of States to govern and control the institutions in their State. I think that applies as far as the insurance powers as well as the banking powers.

Senator BRYAN. So you would be satisfied, and let me make sure I am understanding your response, you would be satisfied with the framework in which that responsibility would be left up to the States?

Mr. HOVE. Yes.

Senator BRYAN. I thank you.

Mr. Chairman, I thank you very much.

The CHAIRMAN. Gentlemen, if my three colleagues will permit me, I think I'm going to ask that any further questions be provided for the record so we can go to our other witnesses.

Let me excuse the two of you and thank you for your testimony.

Let me now call our final panel to the table: Dr. Sophie Korczyk, presenting views prepared for the Alliance for the Separation of Banking and Insurance as well; Mr. James Culberson, representing the American Bankers Association, who is the CEO of the First National Bank & Trust Company of Ashboro, NC; Mr. James Lauffer, representing the Independent Bankers Association of America, who is Chairman, President, and CEO of the First National Bank of Herminie, Irwin, PA; Mr. Chris Lewis, who is here representing the Consumer Federation of America; and Mr. David Malkin, representing the Alliance for the Separation of Banking and Insurance. He is a trustee with the National Association of Life Underwriters.

Let me welcome you all and you can get seated and the others in the room who are either coming in or leaving can get situated.

Let me just say, in the interests of time, what I would like to do is make your full statements a part of the record, and I will do so in each case. I would like you to summarize as best you can and state the points you really want to emphasize. I don't want to hurry you, but I don't want to get caught at the other end either, where we don't have time to digest what you're saying and hear the key points and also perhaps raise some questions with you.

So, Dr. Korczyk, we will start with you and go right down the table.

## STATEMENT OF DR. SOPHIE M. KORCZYK, PRESENTING VIEWS PREPARED FOR THE ALLIANCE FOR THE SEPARATION OF BANKING AND INSURANCE, WASHINGTON, DC

Dr. KORCZYK. Thank you, Mr. Chairman.

I appreciate the opportunity to testify before you on this issue. My testimony today is based on research that I have carried out under contract to the Alliance over the past 5 years, and I will address economic arguments underlying the separation of banking and insurance and dangers to consumers from permitting the erosion of this separation.

Federally-chartered banks and most State-chartered banks may generally not enter into affiliations or associations with other businesses. This separation is traditionally based on the premise that banks play a special role in the economy.

Even if it is agreed that banks are special, however, it is another task to decide the nature and degree of regulation this status justifies. In addition to insuring bank safety and soundness, two of the traditional goals of banking regulation in this country have been protecting consumers through ensuring fair credit markets and preventing excessive bank concentration.

Both banking supervision and the regulation of financial services in general are designed in part to avoid conflicts of interest. Some conflicts could occur if a bank owns or is affiliated with one type of business and is asked to consider extending credit to one of its competitors. Other types of conflicts can occur in a context of coer-

cive bank tying of other services to the extension of credits. This has historically been a concern of bank regulators.

There can be two types of coercion and both can be difficult to discern. Implicit coercion can result from the fact that consumers perceive the credit setting itself as coercive. Accordingly, many feel that tying other transactions will improve their chances of receiving credit.

A study by the American Council of Life Insurance, for example, found that close to half of consumers would open accounts at a bank or savings and loan association to improve their chances of obtaining a loan, and an additional 13 percent would not even attempt to borrow from an institution where they did not already have an account. Expanded bank powers could expand the scope of such implicit tying.

Experience in the markets for credit insurance and title insurance provides two important cases in point. Despite statutory prohibitions, overcharging and coercive tying arrangements in credit life insurance sales by lenders persists. Explicit coercion in such sales can occur at two points, one, the decision to purchase credit insurance and, two, the choice of a vendor.

In many States lenders may legally require credit insurance. Thus, the pressure to purchase insurance need not be improper. Whether or not the lender may require credit insurance, however, may not require the purchase of its own insurance, but a Federal Reserve Board study strongly suggests that lenders are doing just that.

Nearly 90 percent of the borrowers who reported in this particular study that they bought credit insurance on their last credit purchase bought it from the lender. Of those borrowers, a full 22.3 percent appear to have been required to buy the lender's credit insurance. This total amounts to 1 in 5 of all credit insurance purchasers and nearly 1 in 8 of all retail borrowers. I would suggest that this is a significant regulatory failure.

And even those consumers who do not experience overt coercion are not necessarily voluntary purchasers. In one survey 40 percent of retail credit consumers responding did not even know they had credit insurance while they were paying for it.

Similar problems have been documented in the title insurance industry. In several cases savings banks that have acquired title insurance companies have proceeded to refer substantially all their borrowers' title insurance to those companies even when they previously used a wide range of title insurance companies. I would thus suggest that the current regulatory structures are inadequate to police even the relatively limited insurance powers available to lenders.

Savings bank life insurance is sometimes used as an example of a bank's ability to provide superior consumer service in insurance. I believe it is nothing of the kind. Only three States, Connecticut, Massachusetts, and New York allow savings banks to sell life insurance. These States provide State level funds that allow risk pooling among banks on a Statewide basis.

SBLI is a specialized product, however. It is subject to restrictive limits on policy face value and accounts for only about 3 percent of the life insurance in force even in these States and, furthermore,

the conduct of eligible banks in selling this insurance has not been studied. So I would suggest that SBLI is really more of a footnote rather than the whole text for regulators to read.

Another basic issue for bank regulators has been preventing excessive bank concentration and maintaining competition. Advocates of expanded bank powers argue that allowing banks to enter other financial markets would enhance competition benefitting consumers and society through lower costs for financial services.

Even though the share of the Nation's financial assets held by commercial banks has declined, however, it is still the case that banks are the single largest financial players in the financial sector, and therefore expanded bank powers would increase bank concentrations further.

I believe that the provisions of S. 543 that the committee will consider in marking up legislation are appropriate. I believe that they enhance the ability of banks to compete in special circumstances while protecting the traditional separation of banking and insurance, and I believe this separation should continue to stand.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

The CHAIRMAN. Mr. Culberson.

## STATEMENT OF JAMES M. CULBERSON, JR., REPRESENTING THE AMERICAN BANKERS ASSOCIATION, CEO, FIRST NATIONAL BANK & TRUST COMPANY, ASHEBORO, NC

Mr. CULBERSON. Thank you, Mr. Chairman and Members of the committee.

I'm Jim Culberson, chairman and CEO of First National Bank & Trust Company, a community bank with approximately $240 million in assets located in Asheboro, NC. I appreciate this opportunity to testify on behalf of the American Bankers Association.

As you know, interstate banking in the past has spawned a wide variety of views among bankers, but today it is clear that for all intents and purposes interstate banking is already a reality. Only one State does not have some type of interstate banking law, and several States are moving toward interstate branching through State legislative action.

Prior to FDICIA the ABA adopted a position stating that the Association would support a phasing out of Federal restrictions on interstate banking and branching as long as two criteria were met: First, individual States should have the right to opt out of the system by action of the State Legislature; second, State laws that govern the method of initial entry of out-of-State banks should be protected. For example, a number of States permit out-of-State banking institutions to enter their State initially only by the acquisition of an existing bank in that State.

The Senate-passed interstate provision containing Senator Wendell Ford's amendment is consistent with the ABA's position on this issue, although there may be some minor improvements that can be made to the legislative language. We would be pleased to work with this committee and other interested parties on this issue.

The second topic of this hearing, imposing restrictions on bank insurance activities, is of tremendous long-term significance to our industry and our customers. Bankers strongly oppose combining insurance sales restrictions with interstate banking and branching in one legislative vehicle. In fact, we will strongly oppose any bill which contains new restrictions on the insurance activities of banking institutions.

We have been authorized to inform you that ABA is joined in this position by the Association of Reserve City Bankers and the Consumers Bankers Association.

There are three primary reasons for our opposition.

First, such restrictions totally ignore the dramatic changes that have taken place in financial markets. For years now this committee has heard testimony on the increasing integration of financial markets. Yet, once again, some advocate imposing additional restrictions on the banking industry which do not apply to our competitors.

Mr. Chairman, this looks to us like an effort to keep the banking industry in the 1950's while the rest of the financial world moves into the 21st Century.

The most recent indication of what the 21st Century will look like is the proposed merger between Primarica and Travelers Insurance. While insurance interests are urging this committee to impose new restrictions on the ability of banks to sell insurance, these two large companies are mixing insurance and banking, as well as securities and a whole host of other financial services, in one giant financial company. It is particularly ironic that the resulting conglomerate will itself own an FDIC insured bank.

Second, banks are the only providers of credit that are limited in their ability to sell insurance. There is no justification for singling out banks and bank customers in this fashion. Savings and loans, credit unions, mortgage companies, finance companies, and other lenders like Primarica can all be associated with insurance agencies and can offer combinations of banking and insurance products, but not commercial banks.

A third important reason why bank sales of insurance should not be restricted is the current concern about the availability and price of insurance services. The availability and cost of insurance products are very important consumer issues in many States. For example, hurricane damage and lack of insurance in inner-cities have raised significant concerns.

The bottom line is that it simply makes no sense to limit any proprietor from selling insurance when the need is so great. The consumer will be the real winner from the added competition from the banks.

Mr. Chairman, the banking industry is ready, willing, and able to work with you and your committee in the pursuit of more open markets, freer competition, and a better deal for the consumer.

Thank you.

The CHAIRMAN. Thank you.

Mr. Lauffer.

## STATEMENT OF JAMES R. LAUFFER, REPRESENTING THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA, CHAIRMAN, PRESIDENT, AND CEO OF THE FIRST NATIONAL BANK OF HERMINIE, IRWIN, PA

Mr. LAUFFER. Thank you, Mr. Chairman. Thank you for the opportunity of being here, and congratulations on your work on the Banking Committee and good luck in retirement.

I'll try to cut down my presentation. We come to you opposed to Federally mandated interstate banking and branching, and it's not because we fear competition. In fact, most of the small community banks compete very successfully against the larger banks.

There are five things that I'm going to outline to you that are the basis of our opposition and I will discuss what we think will happen in this marketplace. One is unfair competition. Two is increased financial concentration. Three is harm to consumers. Four is decreased credit available to small business. And, five is loss of local control of the financial system.

Now the major banks have an unfair competitive advantage against the smaller community banks, especially the "too big to fail," and there have been numerous questions about the "too big to fail" by Senator Sasser. That question was danced around, but I would take a position on that, that we will create more banks that are "too big to fail" in answer to your question to Governor LaWare.

There are going to be too many banks that are going to cause a systemic risk to the bank insurance fund and to the country. So we're just going to create more. My question, Mr. Chairman, would be why would we promote a law that would create more banks in this category?

Larger banks also have an advantage in regulatory burden. We have the same burdens, but they are able to supply big staffs for CRA and for the other regulatory burdens that small banks are not able to do.

The biggest concern I have as a 33-year banker and as a citizen is that mandatory interstate banking and branching is going to bring about more financial concentration in this industry.

I hold up the American Banker of September 30, that lists the one hundred largest banks in this country. They control 73 percent of the total assets in this country.

I'm sorry that Senator Bryan left the room because I would like to say that Nevada is what is called a non-player. There are various States missing from this list, and I'll tell you who most of them are: Arizona; New Mexico; Nevada; Indiana; South Carolina; Nebraska; Oklahoma; the great State of Texas; and Arkansas. These are non-players now, which means that somebody out of State controls most of their banking assets.

Now, you say, who are the winners? The winners so far, and this is half time, the winners so far are: New York; California; North Carolina; Ohio; Pennsylvania; Illinois; and your great State of Michigan.

If we go through with this legislation you're going to find a lot more non-players on this list. There are going to be many more States that have no control over their financial assets.

Let me tell you what that means, in my opinion. If you have one hundred banks here with approximately 20 directors each, that's 2,000 people across this country in various segments, five or six different places, making decisions for the whole banking system, and each time another merged bank goes in, that's one less CEO and it's one less set of directors making decisions on a local basis.

The biggest thing that goes with mergers has been the cut in employment. Bauer Financial listed 56,595 bank employees who lost their jobs between 1991 and 1992 because of mergers, and that's going to happen because that's the quickest way you can save money in financial consolidation.

The other thing we think is wrong is that it's a better deal for the consumer. That is not correct and there are many studies that support that it is not correct.

I'm in the Pittsburgh market, and most of the community banks in the Pittsburgh market are priced less than the major Pittsburgh banks. We have Mellon at No. 21 and PNC at No. 10, and we've got six in the State that are in the top 100, and we can guarantee that most studies are going to show you that the community banks actually price less than these large banks when they come in.

Another thing is making small loans. A banker friend of mine in North Dakota told us not long ago that since the first of the year he has made 150 consumer loans ranging from $100 to $1,000, and several housing loans under $5,000. Now you just try to get a loan like that in a major bank. Mr. Thomas, First Chicago's President, said, to be profitable a major bank has to make a loan of $500,000. I submit to you I'm a $200 million bank and I've made business loans for $500, and this doesn't happen in the big banks.

Loss of local control, I think I pointed that out. You're going to read this journal 4 or 5 years from now and you're going to see many, many more winners and more States that are going to be losers.

We support the position of opt in. Give the States a chance to decide their own fate. Why, on a national basis, should we take that away from the States. We think it should be left with the States.

There are a number of independent studies that support everything that I have. It's in our written testimony. But we go back to the point that there is going to be increased concentration, and that's bad for this country in, I think, almost everybody's view.

There is nobody, Mr. Chairman, there is no consumer that I know of in any market that I know of that's pushing for this law. This law is only going to support a very few large, large financial institutions that are going to profit by merging their systems and by buying more markets.

The other thing I would like to talk about is the 5,000, the town of 5,000 insurance. We strongly support, IBAA strongly supports, the authority to offer retail financial products, including insurance and annuities. We welcome the Supreme Court ruling that national bank offices in towns of 5,000 are given special authority to sell insurance, and we think it should be grandfathered. If it's interstate now, that should be grandfathered in the Act. And we also oppose any kind of regulation that would keep us and burden us from selling insurance products, mainly annuities.

I thank you for the time. I'm sorry I moved so quickly, but I know you're under a tight schedule.

Thank you.

The CHAIRMAN. Thank you very much. I appreciate your being mindful of the time, and I appreciate your statement.

Mr. Lewis, we're pleased to have you and we would like to hear your statement now.

## STATEMENT OF CHRIS LEWIS, DIRECTOR OF BANKING AND HOUSING POLICY, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Mr. LEWIS. Thank you, Mr. Chairman.

We are very pleased to be able to testify today. Mr. Chairman, I will summarize my written statement in as short a time as possible.

In short, it seems as though bankers today are having a hard time simply being bankers. We've noticed, increasingly, that if you walk into many bank branches today you often have a hard time finding the teller windows. Personal banking and investment services abound while traditional banking products like savings and checking accounts and even consumer installment loans are difficult to find.

We believe these diversification trends carry tremendous implications for regulation, economic competition, and consumer and community access to traditional banking services. And, we cannot but note, as I discuss in my written statement, that while the industry speeds ahead with expansion, consolidation, and product innovation our Nation's regulatory machinery remains static and outdated. We urge that the Congress first move to restructure, modernize, and consolidate banking regulatory agencies before handing the industry any greater reach into the economy.

Nationwide branching and insurance, like all ideas for new banking activities, we believe must be tested for their impact in three critical areas: their impact on safety and soundness in the deposit insurance funds; their impact on consumers in local communities; and, their impact on the economy with particular emphasis on competition.

With respect to branching, we believe that consumers should rightfully fear a retail banking industry that is dominated by a handful of giant corporations setting fees, interest rates, and determining from centralized far off offices what banking services are available in their local communities. We believe low- and moderate-income consumers, that are already seriously underserved by the current system, would be particularly put at risk.

Interstate branching, we believe, would dramatically erode the accountability to local communities and economies that our current system attempts to provide and would permit giant banking corporations to operate one central bank with branches from coast to coast.

Bankers claim significant savings can arise from mergers. My statement discusses a number of studies that suggest that, in fact, these efficiencies are difficult to find.

Interstate branching would surely increase industry consolidation and concentration, as has been remarked on, both in this panel

and the prior panel. We are concerned, and I'm sorry Senator Mack is not here, but we're glad to see that we're in great agreement with Senator Mack this morning, that increased concentration will expand the market power of fewer and fewer banks and that this will translate into considerable benefits for banks, but little, if any, benefit for consumers and small businesses. These concerns, we believe, hold and are relevant irrespective of their impact on community institutions.

As Senator Bryan noted, community banks have limited capacity to lend on the basis of their size, and consumers are harmed irrespective of the impact on community banks by concentrated markets.

My written statement reviews several Federal Reserve studies that have analyzed the relationship between price and concentration in banking markets. Obviously, these studies have not made it past Governor LaWare's desk or else he has chosen to ignore them. These studies found, and they are studies by Federal Reserve economists, that there are higher loan rates in concentrated markets and that deposit rates are lower in more highly concentrated markets.

Similar studies, again by Federal Reserve economists, observed that in concentrated bank markets price rigidity is exhibited, that is, that banks in concentrated markets are slower to reduce loan rates and have lagged behind the country in raising deposit rates.

The concern here is that as concentration increases in a market, a certain effect of branching we believe, competition will, in fact, be reduced. Any structural reduction in competition will likely lead to conduct which is not disciplined by market forces and we fear that firms exercising this increased market power will be able to engage in exploitive pricing practices because they are unchecked by competition.

We are particularly concerned, as our statement notes, about the impact of increased concentration on deposit prices, deposit accounts, and the cost of deposit accounts for consumers.

I include in my statement some data from the ABA's Retail Banking Reports that indicate that large banks almost universally charge consumers more than their smaller counterparts for essential financial services.

Additionally, I've attached in the statement a recent article from the Wall Street Journal that suggests that many of the large interstate banks that have engaged in merger activity may gage consumers. In this case, it was the Bank of America Security/Pacific merger, and the journal quotes analysts saying that they "expect the bank using its market clout to bombard consumers with fees." We find this very disturbing and would hope that the committee would make certain that if further geographic deregulation is to be permitted that there are safeguards against such practices.

A second area of concern that I'll just briefly highlight, as has been expressed by other witnesses, focuses on the impact of branching on credit availability. Interstate branching will promote large banks with centralized operations, and this will reduce the decision-making authority of local branch personnel and will decrease the accountability of banking corporations to the needs of local communities.

Banks often have difficulty understanding that diversity is a strength and not a weakness, and absentee decisions—inevitable in a nationwide branching system—will only make this unfortunate trait worse and more destructive. We share Senator Sasser's concerns that he expressed to the previous panel that capital mobility provided for under branching may well impair the ability of depressed economies to recover with haste.

I note in my statement a number of recommendations in the branching area that we would like to see the committee consider. I will just highlight one at this point, and that has to do, Mr. Chairman, with your concern about safety and soundness. We recommend that reports of conditions for interstate institutions be broken out on a State-by-State basis and that the regulatory community, investor community, and the public not lose the current State-by-State breakout of multistate banking corporations.

Short and briefly on insurance sales, we have a number of reservations about letting national banks into insurance sales. However, we do note that there are a number of problems of insurance availability in many markets across the country. Not surprisingly, these communities are often the very same communities that banks have had difficulty in extending credit to.

Just briefly, I think we have a fundamental disagreement with the Comptroller's comments this morning on the distinctions between non-banking and banking activities of national banks. He noted that these are "artificial distinctions." We fundamentally disagree with him. Regulatory confusion on banking and non-banking activities has often harmed consumers.

I note in my written statement that banks occupy a very particular place, a niche, in the financial service market and that when considering insurance or any new product it's important that the Congress recognize that the bank's primary product, credit, is a powerful tool in the marketplace, a volatile commodity that can be destructive to competition when improperly combined with other elements in the economy, and I have a number of recommendations in the insurance sales area that we would like the committee to consider. Some of them were in S. 543 as reported and many were not.

The CHAIRMAN. Thank you. I appreciate your effort to stay within the time. I know everybody feels a little hurried and I regret that.

Mr. Malkin, we would like to hear you now, please.

## STATEMENT OF DAVID B. MALKIN, MEMBER, BOARD OF TRUSTEES, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, REPRESENTING THE ALLIANCE FOR THE SEPARATION OF BANKING AND INSURANCE, WASHINGTON, DC

Mr. MALKIN. Thank you, Mr. Chairman, for the opportunity to testify.

I'm David Malkin. I'm a life insurance agent in the New York metropolitan area, and I would classify myself as a small businessman employing a dozen people. Today I represent the National Association of Life Underwriters and all of the other insurance trade associations.

You've asked us to discuss banks' sale of insurance. We endorse the principles outlined in S. 543 passed back in 1991. We're not asking you to reinvent the wheel. We're urging you to reaffirm your prior commitment to the separation of banking and insurance.

The sale of insurance by banks is inherently unfair to customers and to agents not affiliated with the banks. When a bank loans money and sells insurance, the borrower is at a severe disadvantage. What borrower will fail to buy insurance if there is any possibility it will enhance his chance of getting his loan?

Congress has consistently agreed with this policy judgment, but Federal banking regulators have chipped away at the protections enacted by Congress. We feel it's time for Congress to correct the situation.

First, close the loophole created in section 92 of the National Bank Act. Section 92 was enacted as an exception to the general prohibition on the national bank sale of insurance. For 70 years nobody ever dreamed that it meant that a national bank could sell insurance from a small town to any place anywhere at any time.

We wholeheartedly embrace S. 543's closure of this loophole. Sales activities must be confined to the small town and its environs, and national banks should not be permitted to sell title insurance with respect to their own mortgage loans.

Second, Congress should make it clear that the Comptroller is not free to create new insurance powers for national banks. Section 24 of the National Bank Act grants banks incidental banking powers. Over time the Comptroller has interpreted this provision to permit the sale of insurance, first credit insurance, then title insurance, and then annuities. Courts have struck down the latter two.

Where courts have permitted national banks to sell insurance as an incidental power, it should continue to do so. As to other insurance activities, they should be confined to section 92.

Third, please close the Delaware loophole. One State should not be permitted to sanction insurance powers for its banks and then permit them to export those activities to other States, States which wouldn't even give their own banks those powers. Such a loophole currently exists in the Bank Holding Company Act, and Delaware took advantage of it in 1990. We view such an extra-territorial attempt to interfere with the decision-making of another State as illegitimate.

Finally, you should adopt comprehensive consumer protections applicable to all federally insured institutions and their affiliates. Let's tell consumers that any insurance they purchase from the bank is not FDIC insured and not guaranteed by the bank. It's not a deposit.

Strictly separate a bank's lending activities from the sale of insurance to ensure that bank customers are not misled. Let's protect the private financial data of customers. Banks should not be permitted to use non-public customer information to solicit insurance.

Fourth, let's require banks to comply with the State laws governing insurance. The Comptroller has boldly stated that national banks need not do so. Indeed, they do not even have to be licensed by the State in which they operate. Congress cannot allow such unfettered and irresponsible deregulation. It's dangerous for the consumer.

Fifth, do not permit banks to solicit insurance required by a loan agreement before the customer receives a written loan commitment. We are very pleased the committee has taken up this critical issue. We think the time is ripe for Congress to act.

As S. 543 reflects, most of the work has already been done. The hundreds of thousands of insurance agents across the country that we represent stand ready to assist in achieving the goals the Senate has already embraced.

We thank you, Mr. Chairman.

The CHAIRMAN. Let me thank you all. I'm going to submit some questions to each of you for the record.

Let me now go to Senator Sasser. Any questions, Senator Sasser?

Senator SASSER. In the interest of time, Mr. Chairman, the witnesses have been here now for almost 3 hours, and I will submit my questions for the record also.

I thank them all for their testimony.

Thank you very much.

The CHAIRMAN. Senator Dodd.

Senator DODD. Mr. Chairman, I thank them as well for their testimony.

Let me, if I can, just very briefly, Mr. Chairman, submit these in writing, but I think it's important we get at least some response.

Mr. Culberson and Mr. Lauffer, I made the point that we're trying to fashion something here that will be of value to the banking community, and the ABA, of course, is a divided constituency. There are substantial blocks within the ABA that still adamantly oppose interstate banking I understand.

But is it the opinion that the door is absolutely shut with no possible consideration of any compromises at all in trying to achieve the desired results here? I feel very strongly about interstate banking. I think it's an important step to be taking. And I agree, by the way, with some of the caveats of both of you, of opt in and opt out, and believe we can work out something in that area.

But it seems to me also critically important that if we're going to succeed here we consider some of these other questions, including the possibility of some compromise on the insurance issue. Is that absolutely unacceptable, or is there a possibility for some discussion?

Mr. CULBERSON. From our point of view, we have discussed this with our Board of Directors just as recently as last week and our Government Relations Council, and we're concerned that whatever might occur would result in more restrictions on insurance, and from that standpoint we would oppose it.

Senator DODD. Mr. Lauffer.

Mr. LAUFFER. We're opposing anything that would take the right away from us to sell annuities and some insurance products that are already out there. We think they should be expanded on a Statewide basis for our members, but we would compromise as far as nationwide. We feel if it could be done on a Statewide basis that we would compromise and not need nationwide. We don't feel our members really need nationwide powers to sell insurance.

Senator DODD. I made the point of the absurdity of this situation. Clearly, what was in the thought process in 1916 with a town of 5,000 loophole is substantially different than what people are

talking about today. Clearly, that was to enhance the powers financially of small banks and small towns because of the unavailability of financial services.

The courts ruling recently, in this Land Title Association versus Clark, American Land Title decision, in which the Second Circuit Court of Appeals held that section 92 bars national banks from selling title insurance, all coming off this town of 5,000 concept, seems to me to be absurd. It seems absurd that that becomes the basis by which we're deciding policy on something as critical as this. Do any of you disagree with that?

Mr. CULBERSON. I couldn't agree more with your comments.

Senator DODD. Mr. Malkin.

Mr. MALKIN. We think that the original intent by Congress was to help those communities where they didn't have access to services, insurance, and credit, and we think that Congress should uphold that intent. We think it's a charade for a large national bank to have to buy a branch in a town of less than 5,000 and then export its product all over the country. We don't think that was ever envisioned and we would like Congress to reaffirm the original intent.

Senator DODD. Mr. Lewis, very quickly on your concerns about interstate banking, coming from New England many of us feel that had we had greater access to resources a lot of very fine institutions that just got caught up in things would have survived in the last few years. A lot of people got hurt. A lot of innocent people got hurt in that process, and one of the arguments is that this happened because we didn't have the resources around to sustain them during a very wrenching recession in our area.

If I take your position, what would stop that from happening again in my own area or in other parts of the country?

Mr. LEWIS. I think our principal concern arises in the area of the impact of concentration.

Senator DODD. That has happened already. You heard in Nevada where basically you've got two banks out there that run 80 percent of the show.

Mr. LEWIS. I doubt they're experiencing quite the problems that you had in New England, but they are having some credit availability problems that Senator Bryan associates with the level of concentration.

That is our concern, and to be frank, we don't think that the interstate proposals that have been on the table have adequately dealt with the specific issue of concentration and ensuring that there are safeguards that would mitigate against overconcentration in local banking markets.

We would be glad to give some thought to your specific concern about whether or not entry barriers were a factor in the level of problems that your State and neighboring States have had over the last decade. I really feel a little bit unprepared to respond to that broader economic question at this point. Other panelists may have concerns there, but again I think our concern really focuses on the impact of branching on concentration and what consumers have to pay for that, both in terms of what they're going to get on a deposit account and what the price and terms of credit would be with a

credit delivery system dominated by out-of-State credit decision-makers.

Senator DODD. Let me just lastly point out, not to belabor the point, but Mr. Culberson has pointed out that basically we have interstate banking that's a patch-work operation. I think there are 48 or 49.

Mr. CULBERSON. Forty-nine.

Mr. LAUFFER. Senator, that's the point. What's the big deal then? What do they want if we already have it? Large banks have been able to go all over this country and diversify in loans. You can look no further than Continental Illinois who went to Oklahoma, and Seafirst was brought to its knees with oil loans in Oklahoma. They have had the right to diversify loans all over this country for many, many, many years.

So the diversity thing is not there. You say we have a patch-work system, and maybe we do, but what do they want? If it's there already, what do they want? They want the core deposits that are out there in communities and in States that they can use to make a spread against, and if they're going to find a better loan in California for those funds in Nevada, that's where that money is going to go. Money seeks its highest return. The only thing that you can put in is "X" percentage of loans made in Nevada or a CRA statement that would force them to do that. But if you say it's already there, then what are we here for? What do they want? They want the core deposits is what they want.

Senator DODD. I appreciate your point, but I think it's a bit more than that. I said it's there, but it's also done in a very, very sketchy way and it's not complete. I mean maybe they'll go across one or two State lines, but they don't move all around. We have regional compacts and so forth.

Clearly you're right, to some extent, that they do seek their level, but nonetheless being able to move resources around, would have made a big difference, a big, big difference in my area. We lost a lot of very fine institutions in my State because, frankly, the resources weren't there. A lot of people got hurt, in my view, and community bankers are not going to be adversely affected one way or the other on this thing.

But, frankly, the present system is something that looks like Rube Goldberg created it, and I think it's our responsibility, a consumer responsibility to try to have some consistency with this and some general rules that apply to everyone across the board.

Mr. LAUFFER. It has given the banking network this last year some of the highest profits in history.

Senator DODD. The issue here isn't whether there are profits or not. The point is whether or not consumers are going to be able to have access to capital and the capital moves around.

I have a lot of small businesses, and I listen to the testimony of some and they say there is a lack of demand. Not in my area. There is a lack of response because, frankly, there was too much money being made in Treasury bills and credit card loans instead of small business loans. Maybe if we had more alternatives in the area for people, or if someone stepped forward and said I'll let you borrow the money for your small business enterprise, we might not be suffering as much as we have been.

So I think the more competition you can get is extremely healthy, and I'm not persuaded by the arguments that this drives an awful lot of good community bankers out of business at all.

Mr. LAUFFER. We're not putting that forward, Senator. We're not putting that forward at all because we can compete against them and each one of us does. We're putting forth the concentration of assets. You've got one bank in your State with $25 billion. Are those assets in your State or the State of Massachusetts at Shawmut? What's the percentage of your assets that are out-of-State?

Senator DODD. I remember seeing studies a few years ago that indicated that even in small banks a lot of their assets were out-of-State as well. I mean they weren't limited just to the local resources.

Mr. LAUFFER. We're pretty much limited in loans to the CRA statement that we draw to serve our communities. We're limited to that.

Mr. LEWIS. Senator, if I might just follow up. I appreciate the concern about the need for diversity and diversification on the lending side. Through the Holding Company Act, you know, banks today can operate loan production facilities in any State.

The flip side of that, as I think a couple of other Senators were pointing out, is that you might have overconcentration of assets in a particular region or, as others have pointed out, in a particular industry within a region.

I will go back and look and report back in writing, but I believe this was one of the problems with the Bank of New England, that it had an overconcentration of investment, not in New England, but in Florida and other regions of the country that obviously didn't help your local communities.

Senator DODD. I made the case that the Bank of New England didn't mean to be shut down anyway. I think that was an overreaction quite frankly. At the time I think that bank could have survived.

Mr. LEWIS. And very shortly, on entry barriers. Removing entry barriers does not necessarily guarantee competition. That, I think, is where we would like to make certain that the committee focus some resources. You can remove entry barriers and create an overconcentrated market that has deleterious economic and social impacts. Just simply removing entry barriers does not necessarily guarantee competition.

Senator DODD. I didn't mean to suggest to you, if you thought that, that that was the case at all. But clearly allowing a greater degree of concentration to exist, as it presently does, in too many areas is also not healthy.

At any rate, your testimony here is valuable and we appreciate it. I'll tell you what I said to the last panel, and I presume you all heard it, and that is we're going to make an effort here.

I would just say that I realize people take their positions here, but if the positions are as hardened in certain areas, then we've had a wonderful hearing here today, and we'll have a wonderful one in November, and absolutely nothing will happen and this will all be decided by courts, which frightens me frankly, and it's not the way we ought to be proceeding.

So there is going to have to be some accommodation here in order to get some things done, and I would urge you to go back and communicate with your respective boards and others on that particular point. And obviously if you take the position that you're just adamantly opposed to interstate banking, then that's one particular point of view, but I think there is a majority here that feels as though we ought to do something in that area, and if we're going to, then we're going to have to try to reach some accommodations to achieve that.

Mr. LAUFFER. Let me clear up one thing. We're not opposed. We're supporting opt in by the State.

Senator DODD. I understand that.

Mr. LAUFFER. And we're supporting some concentration levels by percentage that give States protection for the assets in the State.

Senator DODD. I understand that.

We'll look forward to that ongoing discussion in the next few weeks. We have to make a decision on this fairly quickly whether or not we're going to go forward, in my view, because if we don't, you get into the next calendar year and basically my experience is that something like this will not make it in the midst of everything else going on.

We have a window here that is open, and for those who care about these things we have to take advantage of the window or, in my view, it shuts and it's another day and maybe something happens and maybe it doesn't, but it will be a long time.

So, with that, I thank all of you for coming today, and this committee will stand adjourned.

[The committee adjourned at 12:45 p.m., subject to the call of the chair.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

## PREPARED STATEMENT OF SENATOR ALFONSE M. D'AMATO

Mr. Chairman, I would like to commend you for convening this hearing, and I join you in welcoming our panel of distinguished witnesses. I look forward to their testimony, and I am sure it will be informative.

Today, the Committee is focusing on two important issues—interstate banking and insurance activities of national banks. I am pleased that today the Committee is once again considering these important policy questions. The Banking Committee held numerous hearings on comprehensive financial reform during the 102nd Congress that clearly demonstrated the benefits of enacting legislation to permit branching across State lines. The hearings also revealed that interstate banking and branching would provide substantial cost savings by allowing a bank to convert its separately run subsidiaries into branches.

During the 102nd Congress, the Senate passed a version of interstate branching in the "Federal Deposit Insurance Corporation Improvement Act of 1991," but these provisions did not survive the conference.

Mr. Chairman, I continue to believe that Congress should continue to press ahead toward the goal of accomplishing meaningful and broad reform of the financial services industry. Enacting legislation to permit interstate banking and branching would be a significant step in the modernization of our financial system. For this reason, I am pleased to be an original cosponsor of Senator Dodd's bill, the "Interstate Banking and Branching Act of 1993" (S. 371).

The "Interstate Banking and Branching Act of 1993" provides for a balanced approach to permitting interstate banking and branching. States that do not want to participate in interstate branching will be able to "opt out" within a specified time period. By opting out, that State could restrict its banks from branching out of State and prohibit out-of-State banks from branching into that State.

Interstate banking and branching would provide banks with a means to reduce risks through geographic diversification. Banks would be able to diversify their liabilities by making loans in various regions across the country.

Although 33 States have passed laws that allow nationwide interstate banking and 14 States allow regional banking, legislation to permit full-scale interstate banking and branching has yet to pass both Houses of Congress.

I look forward to working with you and my colleagues on the Committee to pass this legislation to bring banking out of the 19th century a few years before we enter the 21st century.

Mr. Chairman, this Committee's version of FDICIA also contained a provision that modified the rule, currently contained in Section 92 of the National banking act, that allows national banks to engage in certain insurance activities in towns with 5,000 or fewer inhabitants. These provisions were not part of the final bill that was enacted into law.

In the interim, Section 92 has contributed to the litigation explosion in our country. In the last year or so, there have been three significant decisions rendered by different Federal circuit courts regarding Section 92. This litigation has not produced uniformity or certainty.

Mr. Chairman, thee scope of Section 92 is a particularly important issue, since it impacts greatly on consumers and providers of financial services. Retail banking and insurance products are among the most popular financial products for ordinary Americans. There are also significant concerns raised by some about the undue influence banks could have in marketing non-bank products to consumers, as well as questions of competitive fairness.

Overall, we owe our duty to the consuming public, and we should keep several objectives in mind as we study this issue:

- First, consumers must have access to financial products that are important to their everyday lives and economic well-being.
- Second, we must assure that the public will not be subject to coercion or irresponsible, hard-ball sales tactics, and that these financial services are fairly priced.
- Third, we must further strive to ensure that the laws that Congress has passed do not provide any player in the financial services industries with an unintended competitive advantage.

Once again, I want to welcome our witnesses. I look forward to their testimony.

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## PREPARED STATEMENT OF SENATOR RICHARD H. BRYAN

I commend you for scheduling this hearing on nationwide banking and branching and insurance activities of national banks. Our Committee wrestled with these is-

sues in the past as part of our consideration of S. 543, FDICIA. I believe it is important that we take testimony on these issues to attempt to bring them to some resolution.

When the issue of interstate branching was raised during the FDICIA debate, I supported it. Since then I have developed concerns about how local economies are affected when their banking assets are control by out-of-State holding companies.

In Nevada, we have a unique situation where 80 percent of the banking assets are control by out-of-State banks. When the two major out-of-State banks experienced difficulties, Nevada's credit needs were greatly short-changed. Nevada's smaller banks attempted to fill the void but, due to loan limits restrictions, could not meet our State's growing needs.

As we proceed on interstate branching, I will work to insure that local credit needs are not lost in the shuttle. If banks ignore the needs of the local economy, I am sure they will be replaced by banks that don't. My concern is that State's like mine don't get caught in a credit squeeze during such a transition.

On the issue of insurance activities of national banks, I have advocated a cautious approach. Expanded bank powers must be done in a thoughtful and reasoned manner. Our grandchildren will still be paying for the sins of a few greedy savings and loan executives who abused the expanded powers granted them in the early 1980's. We must not repeat the mistakes of the past and should proceed cautiously on the issue of expanded powers. It should also be Congress's decision and not regulators who might not share our view of what safeguards may be necessary.

We must put in safeguards to insure that financial institutions do not take advantage of leverage they might have to disadvantage of consumers. As difficult a time as many of my constituents have had getting loans during this credit crunch in Nevada, I would be concerned if they were impositioned to buy other financial products in order to increase their chances of getting a loan.

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## PREPARED STATEMENT OF SENATOR CHRISTOPHER J. DODD

Thank you Mr. Chairman. I want to commend you for holding today's hearing—the first of two important hearings—designed to address interstate banking and branching and insurance issues. These issues are not new to this committee. In 1991, the Banking Committee approved, and the Senate passed a broad banking package that included interstate banking and insurance components. In the House, an interstate banking and insurance bill came within 19 votes of passing.

While we continue to debate the merits of interstate banking and branching, events are rendering our actions obsolete. These issues are no longer a question of "if," but of "when" and "how." Currently, forty-eight States allow some form of interstate banking.

Interstate banking and branching would enhance the stability of the banking industry by permitting banks to diversify their loan portfolios across wide geographic areas. This was one of the major problems thrifts faced during the 1980's. As the economy of the southwest rose and fell, so did the profits of the thrifts in those regions. And when energy prices plummeted, officials found themselves harvesting a bumper crop of failed S&L's. Interstate branching would enable banks to better withstand regional economic difficulties in one area by offsetting them with upswings in other regions.

In addition, interstate banking and branching would allow banks to move capital more easily to credit-starved regions. As our recent experience in New England points out, the consequences of credit crunch difficulties in the face of other economic problems are profound. As the supply of capital in New England dried up, many small businesses with sound track records had no where to turn for credit. As a result, businesses failed and unemployment lines stretched. Interstate branching would help alleviate future regional credit crunches by opening the doors to banks from other areas of the country with the capital to make loans.

Interstate banking and branching would permit banks to achieve considerable savings by consolidating existing multistate operations into single multistate networks. Consolidation would permit banks to reduce duplicate regulatory filings, boards of directors, and legal consultations. It would also allow banks to achieve significant operational savings through branch consolidation, integration, and elimination of duplicate staff functions.

Consumers would also benefit from greater convenience and a wider array of services. An individual working in New York and living in Connecticut would benefit by being able to make loan payments at any branch of his/her bank.

Mr. Chairman, for all of these reasons I have introduced legislation, along with my distinguished colleagues Senator D'Amato, and Senator Kerry, to establish a sensible system for facilitating and regulating interstate banking and branching.

Our bill, S.371 would permit bank holding companies to acquire, one year after enactment, existing banks anywhere in the United States. Eighteen months after enactment, a bank holding company operating subsidiaries across State lines could consolidate them into a single bank. Three years after enactment banks would be able to branch interstate nationwide. States could opt out of branching if they choose—but banks located in States that opt-out would not be permitted to branch interstate.

Our bill also provides safeguards against bank concentration, prohibits undercapitalized institutions from participating in interstate branching, maintains existing community reinvestment act requirements, and requires branches to abide by all other applicable State laws such as consumer protection and fair lending.

At the same time that this committee addresses the issue of interstate banking and branching, it is appropriate that we close loopholes with respect to insurance agency activities and clarify the intent of the Congress in separating banking and insurance issues.

In its decision earlier this year, the D.C. Circuit Court, challenged the Congress to close one loophole which permits banks operating in towns of 5,000 or fewer citizens to sell insurance nationwide. Section 92 of the National Bank Act was enacted in 1916 to encourage banks to operate in small towns by providing banks an opportunity to increase their profitability by selling insurance within the town. Section 92 was never intended to permit national banks to use small town offices as a launching pad for nationwide sales of insurance.

The entry of banks into insurance sales poses significant risks to consumers. It is important that we close existing loopholes in the law and enact meaningful consumer protections for bank customers purchasing insurance.

Thank you again, Mr. Chairman. I look forward to working with you and our colleagues to move an interstate and insurance bill next month. And, I look forward to hearing the comments of our witnesses today.

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## PREPARED STATEMENT OF EUGENE A. LUDWIG

### Comptroller of the Currency

### Introduction

Mr. Chairman and Members of the Committee, I appreciate this opportunity to testify on the scope of activities open to national banks. I should note at the outset that my views are based solely on my perspective as the primary regulator of national banks and should not be taken as an official statement of Administration policy.

Your letter of invitation requested my views on nationwide banking and branching, as well as on the insurance activities of national banks. Since I will be testifying before the Committee on interstate banking and branching on November 2, I will confine my remarks today to the subject of insurance powers.

### Maintaining Safety and Soundness

The primary consideration in assessing any proposal for expanded powers for national banks is the need to maintain the safety and soundness of the national banking system. That is the central objective of bank regulation, and it will be my central objective as Comptroller.

I am glad to be able to report that the financial soundness of most national banks has improved in recent months. Banks have added to their capital reserves, helped in part by several quarters of record earnings. Credit quality is improving in most areas of the country, and the ratio of loan loss reserves to nonperforming loans is rising. Many of the weakest banks have been closed or sold. The bank insurance fund is on a more sound financial footing, in part because the prompt corrective action provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 reinforced the incentives of banks to maintain capital cushions. Low inflation, low-interest rates, and moderate economic growth provides a favorable economic environment for the banking industry I want to make sure that we build upon, rather than squander, these hard-earned gains. We are taking a number of initiatives to reinforce the banking industry's recovering health and to promote the continued safety of the national banking system. The OCC has increased its on-site presence

in national banks and is performing annual, on-site examinations consistent with our statutory mandate. We have increased our examining force to facilitate this increased supervision. At the same time, we are focusing on emerging issues in the banking industry that appear to pose the greatest risk to safety and soundness. Our areas of current supervisory concern include the credit quality of commercial real estate and construction loans; increased emphasis on residential mortgage activities; and interest rate risk and derivative products. The OCC is also conducting a comprehensive review of our methods for supervising and examining national banks to ensure that our efforts are effective and efficient.

As we consider what else needs to be done to ensure the safety and soundness of the banking system, we need to look beyond the current favorable economic climate and recognize that the banking industry remains in a long-term secular decline relative to other sectors of the market for financial services. The banking industry's share of the Nation's financial assets has been shrinking for decades, and that decline accelerated sharply in the 1980's. Large amounts of deposits have flowed out of banks and into mutual funds. Lending to large corporations, formerly a mainstay of the banking business, has dropped sharply, as corporations with strong credit ratings have turned to the commercial paper market as a less expensive source of short-term debt financing. U.S. banks have also lost business to finance companies, insurance companies, and foreign lenders.

Although other kinds of providers now provide an alternative source of many financial services formerly provided almost exclusively by commercial banks, banks still play a unique and important role in our economy. For the communities in which they are located, banks can serve as poles of economic development. They provide combinations of financial intermediation and payments services that are not available from any other financial service provider. They are the principal source of financing for small businesses, which are an important source of new jobs. If banks are to continue to play these essential roles and to remain financially strong, they must be given a fair opportunity to compete with other providers of financial services. Artificial distinctions between "banking" and "non-banking" products should not prevent banks from serving their markets.

## Insurance Powers

The OCC has long taken the view that national banks derive the power to sell insurance from two sources: the general statutory power to engage in the business of banking and activities incidental to banking, and 12 U.S.C. §92, which permits national banks located in places with populations of less than 5,000 to sell insurance generally as agent. The courts have recently accepted the OCC's position that a bank does not need to have a main office, but only a branch in a place of less than 5,000 in order to sell insurance under section 92; and that such sales may be made to customers anywhere.

The OCC has approved the sale of a variety of insurance products, such as municipal bond insurance and credit life insurance, under the incidental powers clause. Some circuit courts have upheld the OCC's actions and views, while two other circuit courts have ruled that no insurance activity falling outside the scope of section 92 is permissible for national banks. I believe this latter view is incorrect as a matter of law.

The sale of insurance poses very little risk to national banks: certainly less than that involved in lending. Insurance sales, like other agency and brokerage activities, do not involve any extension of credit, because the underwriter of the insurance policy, rather than the bank, bears the underlying risk of loss.

## Views on S. 543

In your letter of invitation, you asked for my views on the interstate branching and insurance powers provisions of S. 543, which the Senate passed on November 21, 1991. As I stated earlier, I will confine my comments today to the insurance provisions of S. 543, since I will be appearing again before the Committee on November 5 to discuss interstate branching.

I am concerned that the approach to national bank insurance powers in S. 543 may unduly limit the OCC's authority to respond to an evolving market for financial services. S. 543 would have imposed a permanent moratorium on the OCC's authority under national banking law to permit national banks to engage in insurance activities that are incidental to the business of banking. Since financial markets and the business of banking are constantly evolving, other such products are sure to emerge in the future.

In addition, S. 543 would have authorized national banks and their subsidiaries to sell insurance in any State, but only to the extent that State law permitted banks

chartered by that State to sell insurance. Throughout the history of banking in the United States, competition between national and State-chartered banks has promoted innovation in financial services, increased consumer choice, and helped keep prices low. I am concerned that limiting the insurance powers of national banks to those authorized for State banks would reduce the scope of competition and the benefits that it provides.

Finally, S. 543 would have substantially restricted the authority of national banks to sell insurance in places with populations of 5,000 or less. Sales would have been permitted only to persons residing, working, or owning property in the place. Such restrictions could make it impractical for some banks, such as those located in sparsely populated areas, to offer insurance under this provision.

## CONCLUSIONS

No banking service is completely devoid of risk. But providing insurance services as agent or broker is about as safe an activity as can be imagined. Permitting national banks to sell a broader array of insurance products and services would not pose any material risk to the safety and soundness of individual banks, or any systemic risk to the banking system as a whole.

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# PREPARED TESTIMONY OF ANDREW C. HOVE, JR.

## ACTING CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. Chairman and Members of the Committee: I appreciate this opportunity to testify generally, on interstate banking and branching and the insurance activities of national banks, and specifically, on provisions of S. 543, as passed by the Senate in 1991, which addressed these issues.[1] These are components of a broader topic: the ability of banks to compete effectively in today's dynamic financial marketplace. That ability is certainly subject to some question.

The world has changed a great deal since the constraints imposed on banking were put in place. While still an extremely important part of the U.S. economy, banks are not the dominant force they once were. Just twenty years ago, commercial banks held 40 percent of the Nation's credit market assets. Today, the banking industry's share is down to 26 percent. Mutual funds, money market funds, securities firms, mortgage pools, pension funds, finance companies and corporate America have all increased their shares of the Nation's financial assets at the expense of the banking industry.

Restraints that came into being in part because of concerns about undue financial power and concentration of financial resources now, unfortunately, in many cases serve to benefit banking's competitors. In these cases, the ultimate losers are consumers: they are not given the benefits of a fully competitive financial marketplace.

Consequently, as a general matter the FDIC supports the relaxation of the geographic and product restraints on banks provided that the States continue to play a role in the transition. While many of these restraints had a useful purpose at one time, they are becoming less relevant in today's marketplace. Many artificial restraints serve mainly to hinder the ability of the banking industry to compete with nonbank competitors.

We turn now to the two specific topics with respect to which you requested testimony: interstate banking and insurance activities of national banks. In particular, you requested the FDIC's comments on the relevant sections of the 1991 Senate bill, S. 543.

### INTERSTATE BANKING

#### A. *Background and Trends*

Although the Douglas Amendment to the Bank Holding Company Act and the McFadden Act's restrictions on interstate branching by national and Federal Reserve member banks are still on the books, State legislatures have made interstate banking a reality to a significant degree. The 1956 Douglas Amendment allows bank holding companies (BHC's) to make interstate acquisitions if specifically authorized by the State in which the institution to be acquired is located. Maine in 1975 was the first State to enact such legislation. Practically all of the other States have since followed suit with laws permitting some degree of interstate banking operations by BHC's. Currently, 49 States and the District of Columbia allow full-service regional

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[1] Attachment B provides a number of drafting suggestions by the FDIC's Legal Division regarding S. 543.

or nationwide banking. Only Hawaii has failed to enact legislation allowing out-of-State BHC's to acquire local institutions.

Nationwide banking has superseded the regional compact as the predominant form of State interstate banking legislation activity. Under the nationwide terms of State banking legislation, out-of-State BHC's from any State are permitted to acquire local institutions. Thirty-four States currently permit nationwide interstate banking. Thirteen of these States provide for acquisitions without restriction, while the remaining 21 States require reciprocity privileges for their own BHC's. The States with nationwide banking provisions contain 60 percent of the Nation's banks and approximately 75 percent of banking industry assets. Finally, 15 States and the District of Columbia (only 6 of these States are outside the Southeast region) allow regional banking, restricting the right of entry to banking organizations from designated regional States. The current status of interstate banking is summarized in Attachment A.

The Federal Reserve Board estimates that BHC's held approximately $537 billion in bank assets outside their home State at mid-year 1993, representing approximately 23 percent of banking industry assets. Additionally, out-of-State BHC's have achieved substantial deposit shares in several States through acquisitions. Out-of-State BHC's now control more than 40 percent of bank assets in 15 States (Arizona, Colorado, Connecticut, Florida, Georgia, Idaho, Indiana, Kentucky, Maine, Nevada, Oregon, South Carolina, Texas, Washington, and West Virginia) and the District of Columbia.

Marketplace changes explain in large part the expansion of interstate banking. State actions represent a recognition of a new competitive environment challenging banks and the consequent need for banks to diversify and expand geographically. Additionally, economic problems in the Southwest, reflected in the large number of troubled institutions requiring recapitalization, prompted States such as Texas and Oklahoma in 1987 to provide for immediate nationwide entry.

B. *Benefits*

Interstate banking—that is, multistate banking operations either through branches or bank holding company affiliates—offers the potential for several significant categories of benefits: (1) diversifications of assets and lending opportunities, which could strengthen the banking system and help to reduce costs for the Federal safety net; (2) efficiency gains through the consolidation of interstate banking services; and (3) increased competition, which could act to reduce prices and improve the quality of products available to users of bank services.

Regarding diversification, by providing commercial banks with opportunities to diversify deposit sources and loan portfolios and thus disperse risk, full interstate banking could yield substantial benefits to the Federal deposit insurance fund. The insurance funds have absorbed major losses in recent years in rescuing large banking organizations with assets concentrated in a few industries or a limited geographical area. During the 1980's, for example, slightly more than 80 percent of failed-bank assets were in just four States: Texas, Illinois, New York, and Oklahoma. Perhaps if they had been more geographically diversified, banks in these States might have been better able to weather the financial storms that beset local and regional energy, agricultural, and real estate markets.

One historic rationale for restrictions on geographic expansion and entry was to shield banks from competition, allowing them to build a stronger banking system. Ironically, the lessons from Texas and the Southwest in the 1980's, and more recently New England, are that the failure to diversify creates commercial banks particularly vulnerable to regional economic downturns. Full interstate banking would offer many banks significant risk reduction possibilities by providing increased opportunities for building stable retail deposit bases and by diversifying lending opportunities through broadened customer bases.

A second category of benefits of full interstate banking could be substantial efficiency gains from reform of the existing interstate banking system. As an example, McKinsey and Company estimated that eventual savings from bank conversion to branches alone could amount to $10 billion annually,[2] which is impressive for an industry with net income of $18.5 billion in 1991, and $28.9 billion in 1992. The $10 billion annual savings perhaps overestimates the potential, but few observers dispute that removal of interstate banking barriers would result in at least some savings to the industry.

Title III of S. 543 would have provided a structure for the type of reform which could lead to efficiency gains. S. 543 would have permitted interstate acquisition of existing banks by BHC's, the conversion by interstate BHC's of subsidiary banks in

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[2] *American Banker,* 10 June 1991.

different States into branches, and the establishment, *if explicitly authorized by State law,* of new interstate branches. Thus, S. 543 would have established a uniform scheme for interstate BHC expansion and would have started the banking industry down the road to full interstate branching. Currently, only a small number of States allow interstate branching, and because of the McFadden Act, only State nonmember banks can take advantage of these State laws.

The important role that the States would continue to play under the language of S. 543 bears mentioning. States could apparently elect not to permit in-State banks controlled by out-of-State BHC's to be converted to branches of out-of-State banks. Moreover, *de novo* interstate branching could take place only if explicitly authorized by a State. In this regard, S. 543 would ensure that the States have the same control over interstate bank branching they now have over interstate BHC expansion under the Douglas Amendment to the Bank Holding Company Act. Finally, State-chartered banks would still be subject to State bank supervisors. Some issues concerning State supervision, such as the supervision of out-of-State branches of in-State banks and of in-State branches of out-of-State banks, would need to be addressed, but we do not see these as insurmountable problems.

Note that the FDIC is not necessarily advocating branching as the best organizational form for interstate banking. Some interstate BHC's might prefer a structure with more subsidiary banks and fewer branches than other similarly situated BHC's. The most economically efficient structure for one organization might not be so for another. The point is that banking organizations should have the freedom to select the organizational form with which they are most comfortable.

The third category of benefits from interstate banking concerns competition. Interstate banking should work to increase competition in national and local markets, particularly if banks are allowed entry through *de novo* branching. Consumers may benefit from higher deposit yields, lower loan rates, and better quality services than would exist in an environment of continued restrictions. The small business community, in particular, would likely benefit because commercial banks are its primary credit source.

C. *Criticisms*

Several arguments have been made against relaxing the current barriers to interstate banking. Some analysts have warned that newly-arrived competitors less tied to local markets would channel funds to non-local loan opportunities offering the highest yields. If banks fail to satisfy legitimate local credit needs, however, other institutions will move to exploit this competitive opportunity. Moreover, it is conceivable that new market entrants would inject loanable funds into these areas not only to respond to profitable opportunities, but to establish a local market presence.

Another issue that frequently is raised relates to the fate of small banks in an interstate banking environment. The evidence we have seen suggests that small banks, at least those that are well-managed, will not be hurt by the entry of out-of-State competitors. In States that have long-standing Statewide branching statues, small independent banks continue to exist and often earn returns above those reported by their larger competitors. In California, which has allowed unrestricted Statewide branching since 1927, community banks have prospered despite challenge from the Statewide systems of California's largest banking organizations. Additionally, in this competitive environment, large numbers of *de novo* banks were chartered in the 1980's, underscoring the continued profitability of community banks.

Another concern raised about interstate banking is the possibility of undue concentrations of economic power. In our judgment, current bank antitrust laws and guidelines are sufficient to control undue concentrations in local banking markets. And given the proliferating number of competitors in the financial arena, fears about concentrations of economic power at the State and national levels currently do not appear to be justified. The concentration limits in S. 543—10 percent of depository institution assets at the national level and 25 percent of depository institution deposits at the State level—are a possible way of dealing with such concerns, although we question whether such limits are necessary, too low, or even relevant. In today's financial world, competition regarding the assets and deposits of depository institutions comes as much from nondepository institutions as it does from within the depository institutions industry itself.

D. *Summary*

In sum, generally the FDIC believes that interstate banking is both desirable and inevitable, and will work to the benefit of users of banking services. Safety and soundness problems due to interstate banking are not a concern and, in fact, the banking system may be strengthened. Antitrust laws should be sufficient to deal with the possibility of excessive concentrations of economic power. Although it would

not remove all the restraints on interstate banking, the language of S. 543 would be a step toward that goal. At the same time, S. 543 would give the States a significant role in the speed with which, and in the degree to which, interstate barriers are relaxed. Thus S. 543 may be a good compromise between the likely savings that may occur as a result of unrestricted interstate banking and continuation of the States' historic role in shaping the banking structures that serve their citizens.

INSURANCE ACTIVITIES

You also asked that our testimony address the bank insurance activities provisions of S. 543. Insurance agency and brokerage activities—the selling of insurance—appear, if conducted properly, to pose few safety and soundness dangers for banks. Capital requirements and potential losses are minimal. Government-insured depositor funds are at little risk. Consequently, the FDIC believes that banking participation in insurance agency and brokerage activities is appropriate, and indeed further participation would benefit consumers by increasing competition.

Agency and brokerage activities, however, should be distinguished from underwriting activities, which may entail the possibility of significant losses. In the absence of an effective separation between insurance underwriting activities and Government-insured funds, the FDIC would not support the expansion of banking organization involvement in insurance underwriting activities.

Since the FDIC supports bank involvement in insurance agency and brokerage activities, we do not favor statutory language such as that contained in Section 704 of S. 543. The overall effect of that provision would appear to be a curtailment of insurance sales by national banks.

Note that State banks derive there authority to sell insurance from State law. FDICIA generally limits State banks in the underwriting of insurance to whatever underwriting authority a national bank has, but did not limit insurance sales activities by State banks.

Under current law, national banks have two sources of power regarding the selling of insurance: the incidental powers clause (12 U.S.C. §24 (Seventh)) and the small town authority (12 U.S.C. §92). Pursuant to the incidental powers clause, the Comptroller of the Currency has allowed banks to sell certain types of banking-related insurance. The small town authority permits national banks located in towns with fewer than 5,000 inhabitants to sell any type of insurance. The OCC has interpreted this latter provision to allow national banks located in small towns to sell insurance not just in such towns but anywhere. Thus under the OCC's interpretation, which was upheld in July by the U.S. Court of Appeals for the D.C. Circuit, a national bank located in a small town can use the mail, fax machines, the telephone, or any other technology to sell any type of insurance nationwide.

First, S. 543 would restrict insurance activities under the incidental powers clause to those activities engaged in by one or more national bank on a specified date. Consequently, no additional types of insurance activities could be approved by the OCC as incidental to banking. Thus, national bank insurance powers would not be permitted to develop and adapt to a dynamic technological and financial environment.

Second, S. 543 would permit a national bank to provide insurance as agent or broker to the same extent as banks chartered in the State where the national bank is located. This grant of power might increase the insurance selling powers of a few banks, but it would not likely benefit most national banks. Moreover, in an era of eroding geographic and economic barriers, the tying of financial activities to political boundaries would appear to be a step backwards.

Finally, S. 543 would severely curtail the small town insurance authority. A national bank located in a small town could sell insurance only in and nearby the town. A nationwide solicitation operation by mail, phone, and other technological means would not be permitted. Consequently, because S. 543 would likely restrict rather than expand the insurance agency and brokerage powers of national banks, the FDIC does not favor its approach.

CONCLUSION

In conclusion, the FDIC supports the relaxation of restrictions on interstate banking and on bank insurance agency and brokerage activities. The banking industry needs the freedom to compete in today's financial marketplace. With respect to the Senate passed version of S. 543, the interstate banking provisions appear to provide a start to further reducing the barriers to full interstate banking while maintaining a significant degree of State control of the process. The FDIC generally supports that approach. With respect to bank insurance powers, S. 543 would appear to be a step toward even more restrictions than currently exist. Consequently, for the reasons enumerated in this testimony, the FDIC would not be in favor of the legislation's approach.

Attachment A

# The Current Status of Interstate Banking
# As of September 30, 1993

Nationwide Banking, No Reciprocity

Alaska
Arizona
Colorado
Idaho
Maine
Nevada
New Hampshire
New Mexico
Oklahoma*
Oregon
Texas
Utah
Wyoming

Nationwide Banking, Reciprocity Required

California
Connecticut
Delaware
Illinois
Indiana
Kentucky
Louisiana
Massachusetts
Michigan
Nebraska
New Jersey
New York
North Dakota
Ohio
Pennsylvania
Rhode Island
South Dakota
Tennessee
Vermont
Washington
West Virginia

Regional Banking, Reciprocity Required

Alabama
Arkansas
District of Columbia
Florida
Georgia
Iowa
Kansas
Maryland
Minnesota
Mississippi
Missiouri
Montana**
North Carolina
South Carolina
Virginia
Wisconsin

No Legislation

Hawaii

* Initial entry does not require reciprocity; however, if the bank holding company is not from a state offering reciprocal entry, no further expansion is possible for the first four years.

** Legislation takes effect October 1993.

Attachment B

The FDIC Legal Division has reviewed certain provisions of S. 543 to identify any significant legal issues.

Section 301

This section amends section 3(d) of the Bank Holding Company Act ("BHCA") to permit "adequately capitalized and adequately managed" bank holding companies to acquire out of state banks. The term "adequately capitalized," which is defined in section 38 of the Federal Deposit Insurance Act ("FDI Act"), is not applicable to bank holding companies. This reference should be replaced with a reference to the "required minimum level for each relevant capital measure under regulations of the Board of Governors of the Federal Reserve System." The pertinent regulations are set forth at 12 C.F.R. Part 225, Appendices A, B, and D. The term "adequately managed" is not defined in the bill or in existing regulations.

This section also provides that the Federal Reserve Board shall consider an applicant's record of compliance with federal and state community reinvestment laws in determining whether to approve an application to acquire an out of state bank. However, the Housing and Community Development Act of 1977 ("CRA") is not applicable to bank holding companies.

Section 301 provides that the Federal Reserve Board may not approve an acquisition of an out of state bank if the applicant controls, or upon completion of the acquisition would control, more than 10 percent of the insured depository institution assets in the United States. The following paragraph provides that such an application shall not be approved if the applicant controls, or upon completion of the acquisition would control, 25 percent or more of the insured depository institution deposits in the state in which the bank to be acquired is located. The FDIC Division of Supervision is of the opinion that both paragraphs should refer to the same benchmark, and that the use of the term "deposits" is more appropriate than the term "assets."

Section 302

This section adds a new subsection (h) to section 3 of the BHCA. Subsection (h)(1)(C) provides that if a state decides not to permit interstate combinations within 3 years of the date of enactment of this statute, the state may require that combinations consummated previously be "unwound" and that the acquired bank be converted back into its prior form. The FDIC Legal Division has serious concerns whether this "unscrambling of the eggs" is practical.

Subsections (h)(2)(A) and (B) use the terms "adequately capitalized," "critically undercapitalized" and "capital restoration plan" in reference to a bank holding company. As was noted previously, these terms do not apply to bank holding companies.

Subsection (h)(3)(C) provides that the appropriate federal banking agency approving the merger shall consider the bank's compliance with federal and state community reinvestment laws. It is somewhat unclear whether the reference to approval is intended to mean approval pursuant to the Bank Merger Act. Also, the reference to the "bank's rating" does not clearly state that it means the acquiring bank.

Section 304

This section also amends section 18(d) of the FDI Act. It adds a new subsection (d)(3)(A)[1] which would permit host states to enact statutes permitting out of state banks to open branches in the host state. However, this proposed subsection does not refer to the FDIC's authority to approve new branches by state chartered banks which is contained in existing subsection (d)(1). The FDIC's authority to approve out of state branches as well as in state branches should be clarified.

Section 306

This section permits state authorities to review the books and records of a national bank with a branch in that state in order to ensure compliance with the state's tax laws. It would seem that a comparable provision should be included for state bank branches located in a state which is not the chartering state.

Section 307

This section prohibits bank holding companies from operating a bank in a host state with a name which is deceptively similar to the name of an existing bank in that host state. However, it should be pointed out that, in certain cases, a new affiliate of an established bank will intentionally adopt a name similar to the established bank for marketing reasons.

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[1] This reference to subsection (d)(3) is an error since section 303 of the bill also adds a new subsection (d)(3) to section 18 of the FDI Act.

This section also prohibits a bank from operating a branch in a host state with a name which is deceptively similar to an established bank. The potential problem here is that the use of a different name by an out of state branch may confuse customers into thinking that they are dealing with a different bank and that their deposits in that "bank" are insured separately from their deposits in the other "bank."

Section 704

This section concerns insurance activities of national banks. As such, the Comptroller is the most appropriate party to comment. However, it should be pointed out that the use of the phrase "as principal" in subparagraph (c) seems to authorize national banks to underwrite insurance. The matter is unclear, but this might be interpreted as a significant expansion of national bank powers which state banks would enjoy without regard to section 24 of the FDI Act provided that the state law authorized banks to underwrite insurance.

## PREPARED STATEMENT BY JOHN P. LAWARE

### MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I am pleased to appear on behalf of the Federal Reserve Board to discuss the interstate banking and insurance provisions of S. 543 as approved by the Senate in 1991. For many years, the Board has believed that full interstate banking would benefit bank customers and lead to a stronger and safer banking system, and it has supported the thrust of various legislative initiatives to accomplish that goal. Similarly, the Board has long been on record in support of legislation to update the Nation's banking statutes to allow banks to adapt to changes in the financial services marketplace and to better serve consumers. In this context, we have consistently supported the provision of insurance activities by banks and bank holding companies. Thus, we support the provisions of S. 543 which would permit national banks to engage in insurance agency activities permissible for State banks, but oppose other provisions which limit bank insurance activities.

This morning, in addition to making some specific comments about the 1991 legislation, I would like to explain the reasons for our support of interstate banking and provide information about the current status of interstate activities. To assist the Committee in its deliberations, the appendices to my statement provide an up-to-date summary of State laws regarding interstate banking, a discussion of recent trends, and several statistical tables providing information relevant to the issue.

### NATIONWIDE BANKING

It is perhaps best to start with the observation that interstate banking is now a reality and has been for some time. For years, banks—both domestic and foreign—have maintained loan production offices outside of their home States, have issued credit cards nationally, have made loans from their head offices to borrowers around the Nation and the world, have solicited deposits throughout the country, have engaged in a trust business for customers domiciled outside the banks' local markets and—through bank holding companies—have operated mortgage banking, consumer finance, and similar affiliates without geographic restraint. Since the early 1980's, moreover, individual States have modified their statutes to permit—under the Douglas Amendment to the Bank Holding Company Act—out-of-State bank holding companies to own banks within their jurisdiction. Indeed, today only Hawaii prohibits bank ownership by out-of-State bank holding companies.

While State legislatures have supported interstate banking, and while over one-fifth of domestic banking assets are already held in banks controlled by out-of-State bank holding companies, the Board believes that there is a need for congressional action. Our dual banking system has a desirable genius for resisting Government-imposed uniformity, but the large number of significant differences among the States impedes the interstate delivery of services to the public, and reduces the efficiency of the banking business. The differences in State laws are discussed in the first appendix to this statement, but notable examples include restrictions on the home State of banking organizations allowed to enter some States, reciprocity requirements in some other States, the prohibition of de novo entry, and variable caps on the deposit shares of new entrants in still other States. In short, the States have made clear that they accept—and perhaps prefer—interstate banking, and their legislatures have made interstate banking a substantial reality today, but actions at the State level have resulted in a hodgepodge of laws and regulations that permit interstate banking, but in an inefficient and high cost manner.

Restrictions on both intra- and interstate banking were imposed in an era in which commercial banks were the dominant provider of financial services to households and businesses. These restrictions were clearly intended to limit competition and thereby insulate local banks from market pressures. Over time, branching and other geographic restraints became part of the totality of regulations designed to protect bank profits through limitations on entry and deposit rate competition. In recent years, however, banks have seen their market position eroded by nonbank providers of financial services that are not subject to bank-like regulation. Indeed, the unwinding of the historically protected position of banks, such as the removal of deposit rate ceilings, has proceeded on most fronts as a lagged response to market developments that had themselves been encouraged by those same restraints on banks. Attempts to maintain antiquated geographic restrictions will only protect inefficient banks, disadvantage users of bank services, particularly those like small businesses that still have relatively few alternative sources of credit, encourage the entry of less regulated nonbank competitors, and increase the potential stress on the safety net as the long-run viability of banks is undermined.

Action to provide more uniform rules for interstate banking would provide several public benefits. First, reducing obsolete barriers to entry would increase actual and potential competition in the provision of financial services to those customers that for one reason or another, have, at best, very limited access to out-of-market banks, nonbank lenders, or the securities markets. Bank customers would benefit from the resulting lower prices for credit, higher rates on their deposits, and improved quality and easier access to banking and related services. In addition, a significant proportion of our citizens live in areas where State borders intersect; interstate banking would provide households and businesses in these regions with significantly increased convenience in conducting their banking business.

Second, greater opportunities for geographic diversification through interstate banking could help to restore a level of stability to the banking system that once was accomplished, in part, through protection of local banks from competition. While increased competition from nonbanks has undermined the protection intended to be provided to banks through controlled entry and geographic constraints, those same restrictions have made it more difficult for banks to diversify their risks and seek out new opportunities. Thus, many banks operating in a region that has experienced a local economic contraction have been neither protected by limits on bank competition nor able to avoid the disastrous impacts of dependence on one market for both deposits and loans. Being able to cushion losses in one region with earnings in others would make banks better able to contribute to the recovery of their local economy, and more diversified banks would expose the Federal safety net to fewer losses. Clearly, greater geographic diversification would have provided more stability over the last decade to banks operating in the agricultural areas of the Midwest, the oil patch of the Southwest, and the high-tech and defense regions of New England and California. In short, the elimination of geographic restraints would provide an important tool in diversifying individual bank risk, providing for stability of the banking system, and improving the flow of credit to local economies under duress.

Third, interstate banking would facilitate the allocation of resources to regions that offer both safety and higher return and assist in the reduction of excess banking capacity. The U.S. will continue to be a dynamic economy with both expanding and declining industries and expanding and temporarily declining regions. Banks pinned by artificial geographic restrictions to local areas experiencing difficulties have no choice but to pull in their horns, as it were, to protect their own viability. Only through interbank credit extensions and loan participations can they diversify their portfolio and make loans to borrowers unaffected by the depressed local economy. In fact, many of these institutions no doubt tend to have lower loan-to-deposit ratios in part because of their inability to find bankable local credits. Note that, given banks' long-run interest in geographic diversification, banking offices would still remain in regions experiencing difficulty, but would be in a stronger position to finance local expansion when growth opportunities return.

## Comments on S. 543

The benefits from removal of restrictions on geographic expansion could occur through either the acquisition or de novo chartering of bank subsidiaries of bank holding companies headquartered in another State, or through the establishment of branches of a bank in another State. All of the interstate banking laws enacted by the States provide for interstate banking through bank subsidiaries of bank holding companies, although some States permit interstate banking through branches for State nonmember banks. S. 543 would authorize interstate banking on a nationwide basis through the acquisition of existing banks one year after enactment. The Board strongly supports such statutory change and would recommend that the Congress authorize the interstate acquisition of *de novo* banks as well. Authorizing *de novo* banking should enhance competition in many markets, although we recognize that most expansion would occur through acquisition. The Board also supports removing entirely the McFadden Act's restrictions on interstate branching for national and State member banks. This would permit banking organizations to choose between alternative combinations of subsidiary banks and branches in the manner that best balances their own perceived costs and benefits. S. 543 takes the intermediate step of requiring the States to individually authorize interstate branching outside of the holding company structure. The Board believes that the positive experience with interstate banking, and the efficiencies that can be gained by some institutions through branching, provide a compelling case for authorizing interstate branching without further delay. Moreover, this cautious approach to branching could put independent banks at a competitive disadvantage in branching against banks in holding companies.

A limited number of studies comparing the costs of operating an interstate banking network to the costs of operating a branching system have been done. Those studies suggest that, on average, both delivery systems have about the same cost structure. However, this finding is not inconsistent with the view that for some banks branching may have the lowest cost structure. Indeed, as a matter of logic, the Board believes that the cost savings from elimination of separate boards of directors, separate management teams, and separate capitalization for banks that could be branches would be significant for some organizations. In any event, we believe that no good public policy purpose is served by restraining the freedom of choice of individual banking organizations that know best what is the least cost operating structure for them. We therefore support the provision of S. 543 that would permit interstate banking offices to be converted to branches, should a banking organization choose to do so.

We also support the bill's approach of extending interstate branching powers only to those banks that are at least adequately capitalized and adequately managed (which we assume means having acceptable supervisory ratings). In the Board's testimony during the drafting of and debate about FDICIA, the Board supported the principle of expanded activities only for strongly capitalized banks. In drafting recent regulations, the banking agencies have attempted, where possible, to apply this principle. A policy that rewards stronger banks is a desirable supplement to the regulatory limits imposed on weaker banks. Provisions authorizing the regulators to approve interstate combinations to improve the financial condition of critically undercapitalized bank holding companies are also desirable.

State supervisors would no doubt prefer interstate operations through separate banks in each State, since it is much easier for them to supervise the activities of a single organization in their jurisdiction. It seems to the Board, however, that the criterion of ease of regulation for States is only one part of a broader cost-benefit test. So long as safety and soundness are not compromised, efficiency and least cost are far more important factors on which to base policy. We support the solution to this problem proposed in S. 543. As we understand it, the State in which branches of an out-of-State bank operates would negotiate a supervisory agreement with the bank's home State supervisor that is acceptable to both States and to the relevant primary Federal regulator. Failure to reach agreement would require the primary Federal supervisor to conduct examinations without deferring to the State authorities. Such an approach creates desirable incentives for the States to reach reasonable accord.

When interstate banking is implemented through bank subsidiaries, the bank in each State has all the powers that go with its charter—national or State. However, should interstate banking occur through branches, legislation must clarify whether those branches must limit their activities to those permitted to banks chartered in their host State, to activities permitted to banks in their home States, or—for national and/or State banks—to the powers granted to national banks. The issue of the powers that interstate branches should be permitted to exercise requires balancing a number of competing concerns, including preserving the dual banking system and creating incentives that could make certain types of bank charters more attractive than others. We read the Senate bill as attempting the balance by providing that interstate branches of State-chartered banks may not engage in any activities in the host State that are not permitted for banks chartered by the host State, while national banks would retain the same powers in all States. Under the bill, out-of-State branches of national banks would be subject to the same State laws governing intrastate branching, consumer protection, fair lending and community reinvestment as apply to national banks headquartered in that State.

I should note also that the Board supports permitting foreign banks to establish and operate interstate branches on the same terms and conditions as apply to national and State banks. The Board believes that the provisions of S. 543 that prohibit foreign banks from opening new interstate branches except through an insured subsidiary bank are not consistent with the principle of national treatment and should be reviewed to assure that foreign banks receive parity of treatment in their interstate operations.

Whether interstate banking is achieved through bank subsidiaries, bank branches, or both, and regardless of how powers are exported from the home State to the branching host State, the arguments used by those that oppose interstate banking must be carefully reviewed.

The first concern is that interstate banking would result in undue concentration—and ultimately higher loan rates and lower deposit rates—as large out-of-State banks drive small in-State banks out of business. In-State market evidence simply does not support this contention. All of the relevant evidence indicates that small banks generally survive entry by large out-of-market banks, and are very frequently

more profitable than the entrant. Similar evidence indicates that new large bank entrants to local markets, whether by de novo or by acquisition, are able to expand market share by only modest amounts, if at all.

In the 1970's, for example, when Statewide branching was authorized in New York State, a number of large New York City banks sought an upstate presence by acquiring small banks in these markets. By the early 1980's, the acquired banks had gained on average less than one percentage point in market share, with the largest gain less than three percentage points. The acquired banks or branches continue to have small market shares or they have been sold to local banks, as the New York City banks have exited the market. Experience in California also illustrates the ability of small banks to remain viable in the face of competition from much larger organizations. California has permitted unrestricted Statewide branching since 1927 and several of the State's banking organizations, most notably BankAmerica, have operated extensive branch networks for years. In spite of these extensive branch banks, California continues to have many successful independent banking organizations. For example, as of year-end 1992, there were 395 banking organizations in California of which 101 had less than $50 million in assets. Interestingly, in the period 1981 through 1991, some 311 de novo banks (almost 11 percent of the U.S. total of de novo banks formed in those years) began operation in this unlimited branching State.

In addition to their difficulties in winning customers away from existing banks, entrants by acquisition often are soon confronted with competition from a de novo bank organized by local citizens, at times led by the former managers of the bank acquired. The potential for entry—both de novo and by acquisitions by other banks outside the market—plus evidence of continued small bank success, suggest it is unlikely that there would be consumer harm from interstate banking. It is well to remember that since 1979, while over 5,000 banks were absorbed by merger, about 3,500 new banks were chartered. In addition, while almost 10,500 branches were closed, 24,000 new ones were opened in that period. The vast majority of local banking markets in the United States are incredibly dynamic and sensitive to consumer demand, and interstate banking seems likely to make them more so. The concern that interstate banking would lead to excessive concentration in local banking markets is mitigated further by the fact that antitrust enforcement in banking focuses on maintaining competitive local markets. As indicated by appendix table B–7, concentration ratios have not increased in local markets despite the substantial overall consolidation in banking in recent years. Local competition has been maintained in part because many bank mergers have been between firms operating in different local markets. In addition, increased concentration has been avoided by factors already noted: the antitrust laws, limited ability of new large banks to increase market share, and the continued vitality of small local competitors.

The importance of local markets and the evidence of little change in local market concentration suggest that attempts to ensure competition through Statewide or national deposit caps are unnecessary at best and may, in fact, be anticompetitive to the extent that they prohibit entry. The Board would recommend deletion of the imposition of statewide and national deposit share caps.

Another concern of some is that new entrants will vacuum up local deposits and channel them to out-of-market loans, or that managers brought into local markets will be insensitive to, or have no authority to adjust to, local demands. However, it is important to recall that an insured bank must fulfill its Community Reinvestment Act (CRA) responsibilities in all the markets in which it operates. Moreover, the ease of entry, just discussed, should soften concerns that out-of-market entrants will ignore local customers. If a local branch does not meet both the deposit needs and credit demands of the community, it will not succeed and it will attract a rival that will. In this context, the Board sees no need for the provisions of S. 543 which would require the promulgation of regulations prohibiting the establishment of branches for the purposes of deposit production.

However, because the Board realizes that the expansion of nationwide banking raises a number of issues regarding the impact on local community credit needs, it supports provisions of S. 543 which would amend CRA to require that performance of interstate institutions be assessed on a Statewide or metropolitan area basis. This approach would maintain the concept embodied in CRA that insured banks should be evaluated on overall performance without imposing arbitrary or costly regulatory requirements at the level of the individual branch and would, in the Board's view, provide adequate information to determine that an interstate institution is meeting community needs in the markets it serves.

Finally, in considering the needs of local markets, Congress should consider the fact that large banks have higher loan-to-deposit ratios than small banks. This implies that large banks entering new markets could make both more in-market loans

and more out-of-market loans. Many assume that most of the loans would, in fact, be made outside the community. However, as I noted, banks must both meet their CRA requirements and service their customers in order to remain competitive in the market. It should also be kept in mind that small, independent banks also export funds: they are relatively large lenders to other banks through the Federal funds and correspondent deposit markets, and purchase relatively more Treasury and out-of-market State and local bonds than large banks.

## Limitations on Bank Insurance Activities

The Committee has also requested the Board's views of the insurance provisions included in S. 543 as approved on the Senate floor. S. 543 would permit national banks to engage in insurance agency activities in States that permit State chartered banks to conduct these activities. In these States, national banks would be subject to the same rules and limitations that govern State banks that conduct insurance agency activities. The bill would also prohibit any banking organization—State or national—located in a State that authorizes banks to sell insurance from selling insurance in another State unless that State also had authorized the sale of insurance by banking organizations.

Another provision of the bill would restrict the authority of national banks to sell insurance in small towns where the State has not otherwise authorized State banks to act as an insurance agent. The bill would overrule the OCC's current interpretation permitting national banks to use small towns as a base for selling insurance products broadly. Under the bill, national banks would be restricted to selling insurance to residents, businesses and workers within towns of 5,000, and within a 7.5 mile radius of these towns.

An insurance provision of S. 543 that was enacted as part of the FDIC Improvement Act prohibits State banks from engaging in insurance underwriting activities other than underwriting credit related insurance. The bill retains the general prohibitions on bank holding companies selling or underwriting insurance, and does not expand the limited exceptions to these prohibitions, which currently limit bank holding companies primarily to credit related insurance activities, certain grandfathered insurance activities, and insurance agency activities within small towns.

The Board has consistently supported the provision of insurance agency activities by banks and bank holding companies, and believes that increased bank participation will enhance competition and improve customer convenience without adversely affecting safety and soundness. Thus, the Board sees no argument on either competitive or risk-management grounds to retain or impose limitations on insurance agency activities.

A number of States already permit their State chartered banks to engage in insurance agency activities. The Board supports the bill's provisions to amend the National Bank Act to authorize national banks to conduct insurance agency activities to the same degree permitted for State banks in those States. However, the proposed limitations on existing authority to conduct insurance agency activities outside the State in which the bank is headquartered and the limitations on insurance activities in small towns promise continuation of the fractured and anti-consumer rules which currently hobble the banking industry, stifle competition and innovation, and divert resources toward legal and regulatory maneuvering. Particularly in the context of today's debate over the nature of appropriate regulation, there exists little justification for devising a system of artificial controls based on the kind of statutory limits on population and geography proposed in S. 543.

It is also the position of the Board that insurance underwriting activities should be authorized for banking organizations so long as the activities are conducted in a separate holding company subsidiary. While certain types of insurance underwriting activities pose more risk, those risks can be successfully managed and insulated from the deposit insurance fund through the umbrella of the holding company. The Board sees no reason to prohibit insurance underwriting activities when conducted in a holding company.

In sum, the Board believes that interstate banking and branching and broader insurance authority would provide wider household and business choices at better prices. These needed reforms would also strengthen our Nation's banking system by increasing competitive efficiency, eliminating unnecessary costs associated with the delivery of services, and encouraging the reduction of risk through geographic and product diversification.

## APPENDIX A

### The Status of Interstate Banking

Federal law and regulations prior to 1956 did not prohibit multistate bank holding companies, but in floor debate on the Bank Holding Company Act of 1956 Senator Douglas introduced an amendment that still has a profound influence on the structure of the banking industry. The Douglas Amendment prohibits a bank holding company from acquiring a bank outside its home State unless the acquisition is specifically permitted by the statutes of the home State of the bank to be acquired. In 1956, no State had a statute to allow bank acquisitions by out-of-State bank holding companies; thus, no new multistate organizations could be formed.

The Bank Holding Company Act, while effectively prohibiting new interstate banking organizations, provided grandfather rights for the existing multistate companies. They could retain their existing subsidiary banks, even though the acquisition of additional banks was not permitted. There were only 19 multistate organizations that were grandfathered in 1956. Most of the 19 were quite small, and the four largest held 86 percent of the deposits of the 19 interstate organizations.

The Bank Holding Company Act of 1956 regulated only multibank holding companies. The smaller multibank, multistate organizations preferred to reorganize and give up their grandfathered *multistate* operating rights in order to avoid the new Federal regulations being applied to *multibank* holding companies. Thus, over time, the number of grandfathered multistate bank holding companies decreased to seven.

The option to allow bank acquisitions by out-of-State bank holding companies, provided to the States by the Douglas Amendment, went unused until 1975. In that year, a general revision of the Maine State banking code permitted the acquisition of Maine banks by out-of-State bank holding companies beginning in 1978. The Maine law initially required reciprocity; Massachusetts bank holding companies, for example, could only buy Maine banks if Maine bank holding companies were allowed to buy banks in Massachusetts. Because of the reciprocity requirement, no acquisitions of Maine banks were possible until other States enacted statutes allowing the acquisition of their banks by Maine bank holding companies.

Other States began enacting interstate banking statutes in the early 1980's with Alaska, Massachusetts, and New York passing laws that became effective in 1982. In subsequent years, all States except Hawaii enacted some form of interstate bank holding company law.

### The Interstate Bank Holding Company Laws

The interstate bank holding company laws passed by the States and the District of Columbia in the years 1975–1993 vary on a number of bases. Appendix table A–1 details the major provisions of the interstate banking laws of 49 States and the District of Columbia. On the Federal level, the Garn-St Germain Depository Institutions Act of 1982 amended the Bank Holding Company Act of 1956 to allow for the interstate acquisition of large failed banks.

Thirty-four States now provide for the acquisition of their banks by out-of-State holding companies headquartered in *any* other State. Many of these States began their interstate banking period by allowing for entry from a limited list of States. Later, either at a predetermined trigger date or by subsequent legislation, the limited number of States from which entry was permitted was expanded to allow nationwide entry.

However, twenty-one of those States that allow nationwide entry require reciprocal entry rights for their bank holding companies. Thus, although New York, for example, provides the potential for entry by bank holding companies headquartered in any other State, actual entry into New York is only allowed if the home State of the bank holding company allows entry by New York bank holding companies. Given that all States do not allow entry by New York holding companies, not all holding companies can enter New York. When they do allow entry from New York, they will simultaneously gain entry rights into New York. States that do not include a reciprocity requirement in the provisions of their interstate banking laws can be entered by bank holding companies located in any other State, regardless of the laws of that State.

Except for Hawaii, the sixteen States that do not have provisions for nationwide entry allow, or in the case of Montana will allow, entry from selected States within a region that is defined in the enabling legislation. Regions are defined as areas as small as the six adjacent States and as large as 16 States and the District of Columbia.

Although areas such as New England and the Southeast were initially thought of as interstate compact areas, there were no formal compacts or treaties between these States. Each State defined its region as it thought best. Only the Southeastern

States remain as a somewhat cohesive unit, generally allowing entry from the other States in the region and generally excluding bank holding companies from outside the region. Even within this area, however, there are some differences between the regional definitions of the various States. All of the States with limited regions require reciprocity for their banking organizations.

There are a variety of other conditions that have been placed on interstate banking activity as each State has crafted its own law on the subject. Montana, which has the newest legislation on the subject, can be used to illustrate some of the possible features of interstate banking legislation. First, as Appendix table A–1 indicates, Montana has a regional reciprocal law allowing entry from only seven States. Second, Montana does not allow out-of-State bank holding companies to acquire a charter for a de novo bank. A Montana bank must be at least six years old before it can be acquired by an out-of-State bank holding company. Although few large bank holding companies have chosen to enter new markets by forming a de novo bank, the desire to protect the franchise value of the existing bank charters has led to barriers to de novo bank formations as a means of expansion across State borders.

As a third measure, Montana, like 17 other States listed in Appendix table A–2, has placed a cap on the share of bank deposits that can be controlled by any *one* out-of-State organization. Often, those opposing interstate banking argue that the entering out-of-State bank will have major operating advantages over local banks, or will use unfair competitive tactics to acquire an overwhelming share of the State's deposits. Montana's law limits the market share that any one out-of-State institution could acquire to 18 percent of the total of the State's insured bank, thrift, and credit union deposits. Going beyond other States, Montana also limits the combined share of all out-of-State banking organizations to 49 percent of the State's insured bank and thrift deposits.

As a fourth variation, some States designed their interstate banking laws to promote specific forms of economic activity. For example, Delaware encouraged holding companies from other States to establish Delaware banks for the purpose of issuing credit cards and processing credit card transactions. In some States, banks chartered for these specific purposes did not compete generally with the local banks, but rather concentrated on their specific functions.

In spite of the various restrictive provisions initially included in interstate banking legislation, over time the laws have become more permissive. As more States allow nationwide entry, the expansion possibilities increase for bank holding companies in all States. Treating each pair of States (and the District of Columbia) as a combination, there are 2,550 possible two State pairs. For example, Alabama entry into Alaska would be one possibility and Alaska entry into Alabama would be a second, etc. At this time, entry is permitted between 1,570 (62 percent) of the 2,550 possible State combinations.

### The Interstate Bank Holding Companies

There are now 172 domestic multistate bank holding companies. These holding companies, as well as nine foreign bank holding companies with banks in multiple States, are listed in Appendix table A–3. While most of these are major banking organizations in terms of assets, as suggested by their average domestic deposit size of nearly $8 billion, there are 73 with less than $1 billion in domestic deposits that operate banks in two or more States.

One hundred and sixteen of the 181 interstate bank holding companies have subsidiary banks in only 2 States, their home State plus one additional State. At the other extreme, only three holding companies have bank subsidiaries in ten or more States, and two of these organizations—First Interstate Bancorp and Norwest Corporation—are among the grandfathered interstate bank holding companies that held some of their out-of-State subsidiary banks before the Bank Holding Company Act of 1956. Thus far, only a few banking organizations, such as BankAmerica, Banc One, Citicorp, Fleet Financial, KeyCorp, and NationsBank, have made extensive use of the State interstate banking laws and have made significant progress toward becoming truly nationwide organizations.

### Interstate Banking Shares at the National Level

The share of domestic commercial banking assets controlled by interstate bank holding companies has not expanded as rapidly as might have been expected. As of December 31, 1992, 20.81 percent of domestic commercial banking deposits were held by banks owned by out-of-State bank holding companies. While this percentage is relatively low, it began from a very low base consisting only of the seven grandfathered bank holding companies.

A number of possible reasons can be advanced for the slower than expected increase of the interstate banking share of deposits. The first major reason would, most likely, be the financial problems encountered during the period by some of the largest banks. The spread of interstate banking laws coincided with significant banking system problems that left many banks that were expected to expand rapidly without the resources to grow at the anticipated rate.

Second, the economic outcome of those mergers that have occurred is not generally conducive to further mergers. Although some bank holding companies are able to make repeated large acquisitions, integrate the new banks into their organization and increase their profit rates in the process, studies of hundreds of mergers suggest that, on average, mergers do not increase the profitability or efficiency of the combined firm. Studies, over time, have not found the economies of scale that would require firms to grow larger in order to be competitive and profitable. Thus, smaller banks are not under great pressure to be acquired; they can remain independent and still be profitable.

Finally, hostile takeovers are very difficult in banking. Below the top size-tier of banks, only a few have publicly traded stock. Thus, acquisitions must be negotiated in most cases.

As the condition of the banking system continues to improve, additional interstate expansion can be expected. However, such expansion may still be limited by the high share price of the banking organizations that are the most attractive acquisition targets.

### Interstate Banking Shares at the State Level

While the national data suggest that the progression to interstate banking has been relatively slow, the State data presented in Appendix table A–4 reveal a wide variance in the percentage of State banking assets and deposits held by out-of-State bank holding companies. In three States, over 70 percent of domestic banking deposits are held by banks controlled by out-of-State bank holding companies. In seven States, between 50 percent and 70 percent of deposits are under out-of-State ownership. Twenty-eight States have out-of-State ownership of between 10 percent and 50 percent of State banking deposits, and in the final 13 States less than 10 percent of banking deposits are held by out-of-State bank holding companies.

The States in which out-of-State bank holding companies have acquired 70 or more percent of domestic banking deposits are Maine, Nevada, and Washington. Prior to interstate banking, all had few large banking organizations, and a relatively high degree of banking concentration. Thus, only a few acquisitions by out-of-State firms were required to bring over 70 percent of banking deposits under out-of-State control. Another important factor explaining levels of out-of-State ownership is bank failures. Especially in Texas, the percentage of out-of-State ownership is due, in part, to the failure and subsequent acquisition of major banking organizations by out-of-State bank holding companies.

There are a wide variety of explanations as to why some States have very low percentages of out-of-State ownership. Some of these States may not be regarded as particularly attractive for entry because of low-income levels or growth rates. Others States, such as New York, contain so many very large banks that it would be difficult for out-of-State institutions to enter and acquire a large State share. Finally, some of the States have very low levels of concentration; even the acquisition of several of the largest banks could occur without transferring a large percentage of the total deposits to out-of-State firms.

### Interstate Branching

The likely final step in the geographic deregulation of banking is interstate branching. Historically, neither Federal nor State laws have permitted general interstate branching. A few States, including Utah, New York, Rhode Island, and Massachusetts, have recently enacted laws that would permit interstate branching only for State nonmember banks, but there has been no general use of these laws yet.

Over time, however, a number of interstate branches have been maintained. According to the *Summary of Deposits* for June 30, 1992, there were 146 branches across the borders of States, territories or possessions. Most of these branches were owned by U.S. banks in the territories and possessions of the United States, or were U.S. branches of banks in the U.S. territories and possessions. Only forty-two of the branches are between States; they exist for three reasons. First, some were grandfathered from some earlier periods. Second, some were permitted as the means to resolve a failing institution problem. Third, some are branches of banks serving more than one military installation.

## APPENDIX A

### TABLE A–1

### INTERSTATE BANKING LEGISLATION BY STATE (AS OF OCTOBER 1, 1993)

| STATE | LEGISLATION IN EFFECT | AREA | DEPOSIT SHARE CAP |
|---|---|---|---|
| Alabama | Currently | Reciprocal. 13 States and DC (AR. FL. GA. KY. LA. MD. MS. NC. SC. TN. TX. VA. WV. DC). | No |
| Alaska | Currently | National. no reciprocity. | No |
| Arizona | Currently | National. no reciprocity. | No |
| Arkansas | Currently | Reciprocal. 16 States and DC (AL. FL. GA. KS. LA. MD. MO. MS. NC. NE. OK. SC. TN. TX. VA.WV. DC). | Yes |
| California | Currently | National. reciprocal. | No |
| Colorado | Currently | National. no reciprocity. | Yes |
| Connecticut | Currently | National. reciprocal. | No |
| Delaware | Currently | National. reciprocal. | No |
| District of Columbia | Currently | Reciprocal. 11 States (AL. FL. GA. LA. MD. MS. NC. SC. TN. VA. WV). | No |
| Florida | Currently | Reciprocal. 11 States and DC (AL. AR. GA. LA. MD. MS. NC. SC. TN. VA. WV. DC). | No |
| Georgia | Currently | Reciprocal. 10 States and DC (AL. FL. KY. LA. MD. MS. NC. SC. TN. VA. DC). | No |
| Idaho | Currently | National. no reciprocity. | No |
| Illinois | Currently | National. reciprocal. | No |
| Indiana | Currently | National. reciprocal. | No |
| Iowa | Currently | Reciprocal. 6 States (IL. MN. MO. NE. SD. WI). | Yes |
| Kansas | Currently | Reciprocal. 6 States (AR. CO. IA. MO. NE. OK). | Yes |
| Kentucky | Currently | National. reciprocal. | Yes |
| Louisiana | Currently | National. reciprocal. | No |
| Maine | Currently | National. no reciprocity. | No |

TABLE A-1 (continued)

| STATE | LEGISLATION IN EFFECT | AREA | DEPOSIT SHARE CAP |
|---|---|---|---|
| Maryland | Currently | Reciprocal. 14 States and DC (AL, AR, DE, FL, GA, KY, LA, MS, NC, PA, SC, TN, VA, WV, DC). | No |
| Massachusetts | Currently | National, reciprocal. | Yes |
| Michigan | Currently | National, reciprocal. | No |
| Minnesota | Currently | Reciprocal. 16 States (CO, IA, ID, IL, IN, KS, MI, MO, MT, ND, NE, OH, SD, WA, WI, WY). | Yes |
| Mississippi | Currently | Reciprocal. 13 States (AL, AR, FL, GA, KY, LA, MO, NC, SC, TN, TX, VA, WV). | Yes |
| Missouri | Currently | Reciprocal. 8 States (AR, IA, IL, KS, KY, NE, OK, TN). | Yes |
| Montana | Currently | Reciprocal. 7 States (CO, ID, MN, ND, SD, WI, WY). | Yes |
| Nebraska | Currently | National, reciprocal. | Yes |
| Nevada | Currently | National, no reciprocity. | No |
| New Hampshire | Currently | National, no reciprocity. | Yes |
| New Jersey | Currently | National, reciprocal. | No |
| New Mexico | Currently | National, no reciprocity. | No |
| New York | Currently | National, reciprocal. | No |
| North Carolina | Currently<br>July 1, 1996 | Reciprocal. 13 States and DC (AL, AR, FL, GA, KY, LA, MD, MS, SC, TN, TX, VA, WV, DC).<br>National, reciprocal. | No |
| North Dakota | Currently | National, reciprocal. | Yes |
| Ohio | Currently | National, reciprocal. | Yes |
| Oklahoma | Currently | National. After initial entry, BHC must be from state offering reciprocity or wait 4 years to expand. | Yes |
| Oregon | Currently | National, no reciprocity. | No |
| Pennsylvania | Currently | National, reciprocal. | No |
| Rhode Island | Currently | National, reciprocal. | No |

TABLE A-1 (continued)

| STATE | LEGISLATION IN EFFECT | AREA | DEPOSIT SHARE CAP |
|---|---|---|---|
| South Carolina | Currently | Reciprocal. 12 States and DC (AL, AR, FL, GA, KY, LA, MD, MS, NC, TN, VA, WV, DC) | No |
| South Dakota | Currently | National, reciprocal. | No |
| Tennessee | Currently | National, reciprocal. | Yes |
| Texas | Currently | National, no reciprocity. | Yes |
| Utah | Currently | National, no reciprocity. | No |
| Vermont | Currently | National, reciprocal. | No |
| Virginia | Currently | Reciprocal. 12 States and DC (AL, AR, FL, GA, KY, LA, MD, MS, NC, SC, TN, WV, DC). | No |
| Washington | Currently | National, reciprocal. | No |
| West Virginia | Currently | National, reciprocal. | Yes |
| Wisconsin | Currently | Reciprocal. 8 States (IA, IL, IN, KY, MI, MN, MO, OH). | No |
| Wyoming | Currently | National, no reciprocity. | No |

Source: Financial Structure Section, Board of Governors of the Federal Reserve System.

APPENDIX A

TABLE A–2

STATE DEPOSIT SHARE CAPS

| STATE | PERCENT LIMIT | PERCENT LIMIT INCLUDES DEPOSITS OF BANKS | THRIFTS | CREDIT UNIONS |
|---|---|---|---|---|
| Arkansas | 25 | X | | |
| Colorado | 25 | X | X | X |
| Iowa | 10 | X | X | X |
| Kansas | 12 | X | | |
| Kentucky | 15 | X | X | X |
| Massachusetts | 15 | X | | |
| Minnesota | 30 | X | X | X |
| Mississippi | 19 | X | X | X |
| Missouri | 13 | X | X | X |
| Montana | 18 | X | X | X |
| Nebraska | 14 | X | X | |
| New Hampshire | 20 | X | X | X |
| North Dakota | 19 | X | X | X |
| Ohio | 20 | X | X | |
| Oklahoma | 11 | X | X | X |
| Tennessee | 16.5 | X | X | X |
| Texas | 25 | X | | |
| West Virginia | 20 | X | X | X |

Source: Conference of State Bank Supervisors, amended by calls to state banking commissions in some cases.

APPENDIX A
TABLE A-3
INTERSTATE BANKING ORGANIZATIONS AND THEIR DEPOSITS
December 31, 1992

| Banking Organization | Home State | Number of States in which BHC has Insured Commercial Bank(s) | Domestic Deposits (bil of $) | Percent of BHC's Domestic Deposits From Outside Its Home State |
|---|---|---|---|---|
| Livingston SouthWest Corp. | IL | 2 | 0.18 | 100.00 |
| NationsBank Corporation | NC | 11 | 82.55 | 90.38 |
| Fleet Financial Group, Inc. | RI | 6 | 32.28 | 83.64 |
| Peoples Heritage Financial Group | ME | 2 | 0.32 | 81.50 |
| SunTrust Banks, Inc. | GA | 3 | 28.95 | 72.71 |
| T & C Bancorp, Inc. | IL | 2 | 0.12 | 72.18 |
| First Union Corporation | NC | 6 | 38.20 | 72.04 |
| Charter 95 Corp. | MN | 2 | 0.11 | 71.99 |
| First Nebraska Banes, Inc. | NE | 2 | 0.06 | 69.82 |
| Magna Group, Inc. | MO | 2 | 3.34 | 69.72 |
| Banc One Corp. | OH | 8 | 48.06 | 69.41 |
| Valley Bancshares, Inc. | MN | 2 | 0.06 | 69.19 |
| Whitcorp Financial Company | KS | 2 | 0.13 | 68.94 |
| Community First Bankshares | ND | 3 | 0.95 | 68.49 |
| Suburban Bancshares, Inc. | VA | 2 | 0.10 | 67.06 |
| First Illinois Bancorp, Inc. | IL | 2 | 0.15 | 63.58 |
| American Interstate Bancorporation | NE | 2 | 0.10 | 61.65 |
| First Interstate Bancorp | CA | 13 | 43.48 | 61.25 |
| First Heartland Bancorp | NE | 2 | 0.10 | 60.04 |
| Norwest Corp | MN | 11 | 27.04 | 59.95 |
| Community First Financial, Inc. | KY | 2 | 0.04 | 59.67 |
| Chadwick Bancshares, Inc. | IL | 2 | 0.10 | 55.21 |
| First Banks, Inc. | MO | 2 | 1.20 | 53.17 |
| Wachovia Corp | NC | 4 | 22.98 | 50.70 |
| Commercial Bancgroup, Inc. | TN | 2 | 0.17 | 50.57 |
| U.S. Bancorp | OR | 5 | 15.21 | 48.92 |
| NBD Bancorp, Inc. | MI | 5 | 29.29 | 48.00 |
| West One Bancorp | ID | 4 | 5.34 | 47.81 |
| HNB Corporation | KS | 2 | 0.28 | 47.52 |
| Shawmut National Corporation | CT | 2 | 16.54 | 47.40 |
| American Community Bank Group | MN | 2 | 0.23 | 47.37 |
| KeyCorp | NY | 8 | 21.00 | 45.67 |

Table A-3 (Continued)

| Banking Organization | Home State | Number of States in which BHC has Insured Commercial Bank(s) | Domestic Deposits (bil of $) | Percent of BHC's Domestic Deposits From Outside Its Home State |
|---|---|---|---|---|
| First Security Corp. | UT | 3 | 5.51 | 42.24 |
| Resource Bancshares Corp. | SC | 2 | 0.58 | 42.10 |
| American Bancorporation | WV | 2 | 0.26 | 40.46 |
| National City Corp. | OH | 5 | 22.65 | 39.12 |
| Granby Bancshares | MO | 2 | 0.02 | 38.59 |
| Signet Banking Corp. | VA | 3 | 7.86 | 37.53 |
| Mid South Bancorp, Inc | KY | 2 | 0.17 | 36.90 |
| Frandsen Financial Corp | MN | 2 | 0.10 | 36.81 |
| Boatmen's Bancshares, Inc. | MO | 8 | 18.25 | 36.49 |
| Banner Bancorp, Ltd. | WI | 2 | 0.05 | 36.10 |
| Firstar Corp | WI | 5 | 10.88 | 36.03 |
| F.S.B., Inc. | NE | 2 | 0.07 | 35.38 |
| SouthTrust Corporation | AL | 6 | 9.64 | 34.85 |
| Arrow Bank Corp | NY | 2 | 0.66 | 34.24 |
| Otto Bremer Foundation | MN | 3 | 1.78 | 34.23 |
| Reelfoot Bancshares, Inc. | TN | 2 | 0.10 | 34.23 |
| Brighton Bancorp, Inc. | TN | 2 | 0.03 | 33.21 |
| Peoples Preferred Bankshares | GA | 2 | 0.05 | 32.52 |
| First Bank System, Inc. | MN | 7 | 16.60 | 31.99 |
| First of America Bank Corp. | MI | 3 | 16.26 | 31.86 |
| Midlantic Corp. | NJ | 4 | 13.45 | 31.75 |
| Bessemer Group, Inc | NJ | 2 | 0.27 | 31.46 |
| Citizens Holding Company | OK | 2 | 0.20 | 30.81 |
| Bank of Boston Corp. | MA | 5 | 19.84 | 30.29 |
| First Community Bancshares Corp. | IA | 2 | 0.08 | 29.50 |
| Old National Bancorp | IN | 3 | 2.40 | 29.34 |
| PNC Financial Corp. | PA | 6 | 29.39 | 29.33 |
| Hancock Holding Company | MS | 2 | 1.55 | 29.21 |
| Central Bancshares of the South | AL | 3 | 5.00 | 28.93 |
| Dominion Bankshares Corp. | VA | 4 | 7.22 | 28.65 |
| National City Bancshares, Inc. | IN | 3 | 0.42 | 28.40 |
| Chemical Banking Corp. | NY | 4 | 74.05 | 27.87 |
| Chase Manhattan Corp. | NY | 7 | 40.04 | 27.05 |
| Synovus Financial Corp. | GA | 3 | 4.37 | 27.03 |
| State First Financial Corp | AR | 2 | 0.60 | 26.97 |

Table A-3 (Continued)

| Banking Organization | Home State | Number of States in which BHC has Insured Commercial Bank(s) | Domestic Deposits (bil of $) | Percent of BHC's Domestic Deposits From Outside Its Home State |
|---|---|---|---|---|
| Citicorp | NY | 9 | 48.67 | 26.96 |
| Decatur Corp. | IA | 2 | 0.05 | 26.64 |
| BankAmerica Corp. | CA | 9 | 123.70 | 26.22 |
| Mid-Citco Inc. | IL | 2 | 1.28 | 25.02 |
| Huntington Bancshares Inc. | OH | 6 | 9.50 | 24.84 |
| Grenada Sunburst System Corp. | MS | 2 | 1.78 | 24.35 |
| First Dodge City Bancshares, Inc. | KS | 2 | 0.13 | 24.03 |
| Corestates Financial Corp. | PA | 3 | 16.07 | 23.96 |
| FMB Banking Corp. | FL | 2 | 0.08 | 23.78 |
| Western Security Holding Company | NE | 2 | 0.08 | 23.54 |
| F & M National Corp. | VA | 2 | 0.96 | 23.46 |
| Miles Bancshares, Inc. | MO | 2 | 0.09 | 23.10 |
| Arvest Bank Group, Inc. | AR | 2 | 0.99 | 22.59 |
| First Affiliated Bancorp, Inc. | IL | 2 | 0.08 | 22.05 |
| United Community Banks, Inc. | GA | 2 | 0.30 | 21.67 |
| Deposit Guaranty Corp. | MS | 3 | 4.02 | 21.56 |
| MNC Financial, Inc. | MD | 2 | 10.83 | 21.14 |
| Baker Boyer Bancorp | WA | 2 | 0.25 | 20.80 |
| Sierra Tahoe Bancorp | CA | 2 | 0.21 | 20.19 |
| Johnson International, Inc. | WI | 3 | 0.78 | 19.77 |
| UJB Financial Corp. | NJ | 2 | 11.94 | 19.77 |
| Crestar Financial Corp. | VA | 3 | 9.75 | 19.69 |
| Comerica Inc. | MI | 6 | 19.47 | 19.62 |
| Union Planters Corp. | TN | 4 | 4.45 | 19.03 |
| Society Corp. | OH | 3 | 17.60 | 18.86 |
| First Place Financial Corp. | NM | 2 | 0.39 | 18.62 |
| Heartland Financial USA, Inc. | IA | 2 | 0.43 | 18.33 |
| Farmers State Bancorp | OH | 2 | 0.07 | 18.22 |
| Commerce Bancorp, Inc. | NJ | 2 | 1.45 | 18.13 |
| Susquehanna Bancshares, Inc. | PA | 2 | 1.48 | 18.07 |
| Century South Banks, Inc. | GA | 2 | 0.37 | 17.79 |
| Northern Trust Corp. | IL | 5 | 7.99 | 17.77 |
| Glendale Bancorporation | NJ | 2 | 0.22 | 17.51 |
| Union of Arkansas Corporation | AR | 2 | 0.65 | 17.47 |

Table A-3 (Continued)

| Banking Organization | Home State | Number of States in which BHC has Insured Commercial Bank(s) | Domestic Deposits (bil of $) | Percent of BHC's Domestic Deposits From Outside Its Home State |
|---|---|---|---|---|
| Palmer Bancorp, Inc. | IL | 2 | 0.21 | 16.98 |
| WM Bancorp | MD | 2 | 0.33 | 16.77 |
| First West Virginia Bancorp | WV | 2 | 0.09 | 16.63 |
| Star Banc Corp. | OH | 3 | 6.48 | 16.61 |
| First Financial Bancorp | OH | 2 | 1.15 | 16.48 |
| Eufaula Bancorp, Inc | AL | 2 | 0.07 | 16.06 |
| The Lauritzen Corp. | NE | 2 | 0.24 | 16.05 |
| Fourth Financial Corp. | KS | 2 | 4.51 | 16.05 |
| Zions Bancorporation | UT | 3 | 2.72 | 15.48 |
| Wesbanco, Inc. | WV | 2 | 0.84 | 14.81 |
| First Western Bancorp | SD | 2 | 0.24 | 14.71 |
| First National Corporation | MS | 2 | 0.06 | 14.67 |
| Minowa Banshares, Inc. | IA | 2 | 0.16 | 14.11 |
| The Merchants Holding Company | MN | 2 | 0.28 | 13.98 |
| Old Kent Financial Corp. | MI | 2 | 7.09 | 13.94 |
| Riggs National Corp. | DC | 3 | 3.83 | 13.46 |
| Amsouth Bancorporation | AL | 3 | 7.43 | 13.08 |
| CNB Bancshares Inc. | IN | 2 | 1.43 | 12.98 |
| Southern National Corp | NC | 2 | 3.60 | 12.81 |
| First Bank Corp | AR | 2 | 0.51 | 12.43 |
| Vista Bancorp, Inc. | NJ | 2 | 0.31 | 12.42 |
| Fifth Third Bancorp. | OH | 3 | 7.57 | 12.18 |
| Meridian Bancorp, Inc. | PA | 2 | 10.18 | 12.08 |
| First Virginia Banks, Inc. | VA | 3 | 6.02 | 11.91 |
| J.P. Morgan & Co. Inc. | NY | 2 | 5.82 | 11.00 |
| SouthWest Missouri Bancorporation | MO | 2 | 0.11 | 10.77 |
| Citizens Bancorp | MD | 3 | 2.84 | 10.64 |
| First Alabama Bancshares | AL | 4 | 6.72 | 10.54 |
| W.T.B. Financial Corp. | WA | 2 | 0.89 | 10.50 |
| First Commercial Corp. | AR | 3 | 2.55 | 10.35 |
| Citizens Banking Corp. | MI | 2 | 2.09 | 10.08 |
| First United Corp. | MD | 2 | 0.32 | 9.75 |
| Mark Twain Bancshares, Inc. | MO | 2 | 1.89 | 9.66 |
| Bank South Corp. | GA | 2 | 3.65 | 9.65 |

Table A-3 (Continued)

| Banking Organization | Home State | Number of States in which BHC has Insured Commercial Bank(s) | Domestic Deposits (bil of $) | Percent of BHC's Domestic Deposits From Outside Its Home State |
|---|---|---|---|---|
| United Carolina Bancshares Corp. | NC | 2 | 2.49 | 9.64 |
| United Missouri Bancshares | MO | 4 | 3.89 | 9.49 |
| Community Bankshares, Inc. | GA | 2 | 0.17 | 9.36 |
| Valley National Corp. | AZ | 3 | 10.15 | 8.58 |
| Upbancorp, Inc. | IL | 2 | 0.18 | 8.06 |
| Key Centurion Bancshares, Inc. | WV | 2 | 2.60 | 7.98 |
| First Chicago Corp. | IL | 3 | 21.42 | 7.84 |
| BancorpSouth, Inc. | MS | 2 | 1.64 | 7.73 |
| State Bancshares, Inc. | PA | 2 | 0.51 | 7.71 |
| Associated Banc Corp. | WI | 2 | 2.41 | 7.64 |
| Bankers Trust New York Corp. | NY | 3 | 10.29 | 7.58 |
| Pocahontas Bankshares Corp. | WV | 2 | 0.22 | 7.44 |
| BB&T Financial Corp. | NC | 2 | 5.34 | 7.42 |
| Commerce Bancshares, Inc. | MO | 4 | 6.52 | 7.30 |
| Mercantile Bankshares Corp. | MD | 3 | 4.59 | 7.26 |
| Liberty National Bancorp., Inc. | KY | 2 | 3.74 | 6.84 |
| Mercantile Bancorporation | MO | 2 | 7.60 | 6.53 |
| UST Corp. | MA | 2 | 1.80 | 6.06 |
| Provident Bancorp, Inc. | OH | 2 | 3.19 | 5.59 |
| Michigan National Corp. | MI | 2 | 8.30 | 5.42 |
| First Bancorp of Kansas | KS | 2 | 1.08 | 5.39 |
| Marshall & Ilsley Corp. | WI | 2 | 6.17 | 4.72 |
| Citizens Bancshares, Inc. | OH | 2 | 0.43 | 4.44 |
| First National of Nebraska, Inc. | NE | 2 | 3.10 | 4.38 |
| Mellon Bank Corp. | PA | 3 | 24.13 | 3.48 |
| Lincoln Financial Corp. | IN | 2 | 1.76 | 3.48 |
| Barnett Banks, Inc. | FL | 2 | 34.57 | 3.27 |
| Bank of New York Co. Inc. | NY | 3 | 20.94 | 2.91 |
| F.N.B. Corp | PA | 2 | 1.08 | 2.69 |
| First Financial Corp. | IN | 2 | 0.89 | 1.80 |
| U.S. Trust Corp. | NY | 3 | 2.29 | 1.79 |
| United Bankshares, Inc. | WV | 2 | 1.29 | 1.79 |
| Bancorp Hawaii, Inc. | HI | 2 | 5.43 | 1.40 |
| Baybanks, Inc. | MA | 2 | 9.02 | 0.61 |

Table A-3 (Continued)

| Banking Organization | Home State | Number of States in which BHC has Insured Commercial Bank(s) | Domestic Deposits (bil of $) | Percent of BHC's Domestic Deposits From Outside Its Home State |
|---|---|---|---|---|
| Continental Bank Corp. | IL | 2 | 11.20 | 0.00 |
| First Tennessee National Corp. | TN | 2 | 6.17 | 0.00 |
| B.M.J. Financial Corp. | NJ | 2 | 0.61 | 0.00 |
| | | | | |
| Credit and Commerce, Neth. Antilles | VA | 5 | 5.03 | 58.48 |
| A.B.N. - Stichting, Netherlands | IL | 2 | 11.22 | 38.50 |
| National Westminster Bank, England | NY | 2 | 14.99 | 38.09 |
| Banco Santander SA, Spain | NJ | 3 | 26.44 | 30.03 |
| Sumitomo Bank, Japan | CA | 2 | 4.78 | 22.49 |
| Allied Irish Banks, Ltd., Ireland | MD | 4 | 6.75 | 20.28 |
| Bank of Tokyo, Japan | CA | 2 | 13.71 | 9.70 |
| Bank of Montreal, Canada | IL | 3 | 7.31 | 0.96 |
| Saban SA, Panama | NY | 2 | 5.24 | 0.00 |

Sources: NIC Database, Reports of Condition and Income

APPENDIX A

TABLE A-4

OUT-OF-STATE BANK HOLDING COMPANIES' SHARES OF DEPOSITS, BY STATE
DECEMBER 31, 1992

| PERCENT OF DOMESTIC BANKING DEPOSITS HELD BY INSURED COMMERCIAL BANKS OWNED BY OUT-OF-STATE BANK HOLDING COMPANIES | |
|---|---|
| STATE | PERCENT |
| Alabama | 2.51 |
| Alaska | 19.59 |
| Arizona | 64.24 |
| Arkansas | 2.08 |
| California | 14.51 |
| Colorado | 44.70 |
| Connecticut | 39.73 |
| Delaware | 41.71 |
| District of Columbia | 59.43 |
| Florida | 51.21 |
| Georgia | 39.07 |
| Hawaii | 8.74 |
| Idaho | 57.22 |
| Illinois | 24.51 |
| Indiana | 51.23 |
| Iowa | 25.81 |
| Kansas | 1.15 |
| Kentucky | 36.15 |
| Louisiana | 5.17 |
| Maine | 78.48 |
| Maryland | 38.24 |
| Massachusetts | 25.15 |
| Michigan | 3.55 |
| Minnesota | 3.50 |
| Mississippi | 2.25 |

TABLE A-4 (continued)

| STATE | PERCENT |
|---|---|
| Missouri | 0.61 |
| Montana | 37.74 |
| Nebraska | 10.06 |
| Nevada | 91.59 |
| New Hampshire | 27.92 |
| New Jersey | 38.49 |
| New Mexico | 34.61 |
| New York | 21.02 |
| North Carolina | 0.27 |
| North Dakota | 33.58 |
| Ohio | 3.48 |
| Oklahoma | 11.44 |
| Oregon | 48.40 |
| Pennsylvania | 10.67 |
| Rhode Island | 38.41 |
| South Carolina | 63.81 |
| South Dakota | 57.99 |
| Tennessee | 28.39 |
| Texas | 46.98 |
| Utah | 29.24 |
| Vermont | 4.68 |
| Virginia | 22.93 |
| Washington | 72.64 |
| West Virginia | 4.51 |
| Wisconsin | 17.14 |
| Wyoming | 44.03 |
| | |
| National Average | 20.81 |

Source: Reports of Condition and Income, December 31, 1992.

# APPENDIX B
# STATISTICAL TABLES

APPENDIX B

TABLE B–1

NUMBER OF INSURED U.S. COMMERCIAL BANKS. BANKING ORGANIZATIONS AND BRANCH OFFICES 1960–1992

| YEAR | NUMBER OF INSURED U.S. COMMERCIAL BANKS | NUMBER OF BANKING ORGANIZATIONS* | NUMBER OF BRANCH OFFICES |
|---|---|---|---|
| 1960 | 13.079 | 12.791 | 10.216 |
| 1970 | 13.511 | 12.625 | 21.424 |
| 1980 | 14.478 | 12.347 | 38.353 |
| 1985 | 14.290 | 11.008 | 43.239 |
| 1990 | 12.211 | 9.110 | 51.305 |
| 1991 | 11.806 | 9.004 | 53.000 |
| 1992 | 11.363 | 8.729 | 53.744 |

* Banking organizations are the sum of independent banks, one bank holding companies, and individual multibank holding companies. In 1992 there were 867 multibank holding companies.

Sources: NIC Database. Bank–Branch Structure File.
Note: Home offices are not included in branch data.

## APPENDIX B

### TABLE B–2

### ENTRY AND EXIT IN BANKING, 1980–1992

| | NUMBERS | | | | BANK BRANCHES | |
|---|---|---|---|---|---|---|
| YEAR | NEW BANKS | FAILURES OF FDIC–INSURED BANKS | ALL MERGERS AND ACQUISITIONS* | LARGE MERGERS AND ACQUISI-TIONS* | OPENINGS | CLOSINGS |
| 1980 | 267 | 10 | 188 | 0 | 2.397 | 287 |
| 1981 | 286 | 10 | 359 | 1 | 2.326 | 364 |
| 1982 | 378 | 42 | 422 | 2 | 1.666 | 443 |
| 1983 | 419 | 48 | 432 | 6 | 1.320 | 567 |
| 1984 | 489 | 79 | 553 | 14 | 1.405 | 889 |
| 1985 | 346 | 120 | 553 | 7 | 1.480 | 617 |
| 1986 | 283 | 145 | 625 | 20 | 1.387 | 763 |
| 1987 | 217 | 203 | 710 | 21 | 1.117 | 960 |
| 1988 | 234 | 221 | 569 | 18 | 1.676 | 1.082 |
| 1989 | 204 | 207 | 388 | 9 | 1.825 | 758 |
| 1990 | 165 | 169 | 442 | 20 | 2.987 | 926 |
| 1991 | 106 | 127 | 231p | 23 | 2.788 | 1.456 |
| 1992 | 94 | 122 | n.a. | 25 | 1.677p | 1.313p |
| Total | 3.488 | 1.503 | 5.472p | 166 | 24.051p | 10.425p |

p = preliminary data. 1991 merger data includes only Federal Reserve approved transactions.

* These numbers reflect the number of transactions: a merger may involve multiple banks.

Sources:
New bank data and branch data are from the Annual Statistical Digest.

Bank failure data are from the Annual Report of the Federal Deposit Insurance Corporation.

Merger and acquisition data are from Stephen A. Rhoades, "Mergers and Acquisitions by Commercial Banks. 1960–1983," Staff Studies, No. 142 (Federal Reserve Board, January 1985) and annual updates supplied by the author. Large mergers and acquisition data are for mergers in which both organizations have deposits in excess of $1 billion and exclude acquisitions of thrifts and failing banks.

APPENDIX B

TABLE B–3

TOP 25 BANKING ORGANIZATIONS
RANKED BY DOMESTIC DEPOSITS
DECEMBER 31, 1992

| ORGANIZATION | DOMESTIC DEPOSITS (BILLIONS OF DOLLARS) | PERCENT OF NATIONAL TOTAL OF DOMESTIC DEPOSITS IN INSURED COMMERCIAL BANKS |
|---|---|---|
| BankAmerica Corporation | 123.7 | 5.18 |
| NationsBank Corporation | 82.5 | 3.46 |
| Chemical Banking Corporation | 74.0 | 3.10 |
| Citicorp | 48.7 | 2.04 |
| Banc One Corporation | 48.1 | 2.01 |
| First Interstate Corporation | 43.5 | 1.82 |
| Wells Fargo & Company | 42.3 | 1.77 |
| Chase Manhattan Corporation | 40.0 | 1.68 |
| First Union Corporation | 38.2 | 1.60 |
| Barnett Banks, Inc. | 34.6 | 1.45 |
| Fleet Financial Group | 32.3 | 1.35 |
| PNC Financial Corp. | 29.4 | 1.23 |
| NBD Bancorp | 29.3 | 1.23 |
| SunTrust Banks | 29.0 | 1.21 |
| Norwest Corp. | 27.0 | 1.13 |
| Banco Santander SA | 26.4 | 1.11 |
| Mellon Bank Corporation | 24.1 | 1.01 |
| Wachovia Corporation | 23.0 | 0.96 |
| National City Corporation | 22.6 | 0.95 |
| First Chicago Corporation | 21.4 | 0.90 |
| Keycorp | 21.0 | 0.88 |
| Bank of New York Co. | 20.9 | 0.88 |
| Bank of Boston Corp. | 19.8 | 0.83 |
| Comerica Inc. | 19.5 | 0.82 |
| Boatmen's Bancshares | 18.2 | 0.76 |

Source: NIC Database, Reports of Condition and Income.

APPENDIX B

TABLE B–4

NATIONAL CONCENTRATION OF DOMESTIC DEPOSITS IN INSURED COMMERCIAL BANKING ORGANIZATIONS

| | PERCENTAGE OF DEPOSITS HELD BY | | | |
|---|---|---|---|---|
| YEAR | TOP 10 | TOP 25 | TOP 50 | TOP 100 |
| 1960 | 20.4 | 31.7 | 40.3 | 49.6 |
| 1965 | 21.3 | 32.7 | 40.9 | 49.8 |
| 1970 | 20.0 | 30.8 | 38.9 | 48.1 |
| 1975 | 19.9 | 30.6 | 38.7 | 48.2 |
| 1980 | 18.6 | 29.1 | 37.1 | 46.8 |
| 1985 | 17.0 | 28.5 | 40.5 | 52.6 |
| 1986 | 17.6 | 29.6 | 42.4 | 55.6 |
| 1987 | 18.1 | 31.1 | 44.1 | 57.4 |
| 1988 | 19.2 | 33.2 | 47.5 | 59.9 |
| 1989 | 19.9 | 34.1 | 48.1 | 60.5 |
| 1990 | 20.0 | 34.9 | 48.9 | 61.4 |
| 1991 | 22.7 | 37.5 | 49.6 | 61.3 |
| 1992 | 24.1 | 39.2 | 51.7 | 62.6 |

Sources: NIC Database, Reports of Condition and Income.

APPENDIX B

TABLE B–5

PERCENT OF DOMESTIC BANKING DEPOSITS HELD BY
LARGEST BANKING ORGANIZATIONS
DECEMBER 31, 1992

| STATE | LARGEST ORGANIZATION | 2ND LARGEST ORGANIZATION | 3RD LARGEST ORGANIZATION |
|---|---|---|---|
| Alabama | 18.42 | 17.92 | 17.14 |
| Alaska | 42.63 | 25.12 | 18.80* |
| Arizona | 31.63* | 31.17 | 21.25* |
| Arkansas | 11.01 | 10.29 | 4.42 |
| California | 37.35 | 17.29 | 6.89 |
| Colorado | 17.38* | 10.51 | 9.46* |
| Connecticut | 32.69 | 23.95* | 9.66 |
| Delaware | 16.12 | 14.94 | 10.89 |
| District of Columbia | 32.79 | 22.67* | 12.05* |
| Florida | 26.94 | 18.45* | 13.10* |
| Georgia | 16.46* | 13.90 | 11.40* |
| Hawaii | 43.58 | 37.29 | 8.74** |
| Idaho | 34.96 | 28.40* | 12.40* |
| Illinois | 14.01 | 7.94 | 5.13** |
| Indiana | 18.78* | 11.48* | 9.24* |
| Iowa | 12.55* | 6.87* | 4.28 |
| Kansas | 14.54 | 3.91 | 2.96 |
| Kentucky | 12.48* | 11.30* | 10.08 |
| Louisiana | 15.00 | 11.86 | 9.67 |
| Maine | 33.21* | 27.58* | 14.34* |
| Maryland | 20.23 | 12.75** | 10.07 |
| Massachusetts | 23.87 | 15.47 | 13.53* |
| Michigan | 20.20 | 19.66 | 14.30 |
| Minnesota | 24.64 | 23.64 | 2.55 |
| Mississippi | 16.24 | 15.99 | 7.70 |
| Missouri | 20.78 | 12.74 | 10.84 |

TABLE B–5 (continued)

| STATE | LARGEST ORGANIZATION | 2ND LARGEST ORGANIZATION | 3RD LARGEST ORGANIZATION |
|---|---|---|---|
| Montana | 16.89* | 11.10* | 9.28 |
| Nebraska | 15.17 | 12.49 | 8.69* |
| Nevada | 35.64* | 32.52* | 11.61* |
| New Hampshire | 23.59* | 19.25 | 14.49 |
| New Jersey | 21.54** | 11.15 | 10.68 |
| New Mexico | 25.24* | 14.43 | 10.81 |
| New York | 20.71 | 15.50 | 12.84 |
| North Carolina | 20.22 | 19.06 | 14.16 |
| North Dakota | 14.24* | 11.24* | 6.26* |
| Ohio | 16.00 | 15.55 | 15.02 |
| Oklahoma | 8.57 | 7.17 | 4.44* |
| Oregon | 37.79 | 25.22* | 13.10* |
| Pennsylvania | 16.95 | 15.12 | 8.89 |
| Rhode Island | 55.71 | 30.62* | 7.79** |
| South Carolina | 26.45* | 24.87* | 6.61 |
| South Dakota | 29.14* | 18.03* | 4.54* |
| Tennessee | 14.05 | 12.50 | 10.90* |
| Texas | 17.39* | 10.94* | 9.88* |
| Utah | 31.53 | 22.77 | 9.16* |
| Vermont | 28.26 | 20.60 | 15.58 |
| Virginia | 18.19* | 13.79 | 11.75 |
| Washington | 36.12* | 15.00* | 9.64* |
| West Virginia | 14.60 | 14.14 | 7.73 |
| Wisconsin | 16.07 | 13.57 | 10.66* |
| Wyoming | 22.84* | 8.30* | 6.93* |

* Out–of–state bank holding company.
** Foreign bank holding company.

Sources: NIC Database, Reports of Condition and Income.

APPENDIX B

TABLE B–6

BANKING ORGANIZATIONS HOLDING OVER 20 PERCENT OF DOMESTIC DEPOSITS IN INSURED COMMERCIAL BANKS IN A STATE DECEMBER 31, 1992

*PANEL A – BANKING ORGANIZATION IS AN IN–STATE BANK HOLDING COMPANY*

| BANKING ORGANIZATION HOLDING OVER 20% OF DEPOSITS IN STATE | STATE | BHC'S DOMESTIC DEPOSITS IN THE STATE (IN BILLION OF DOLLARS) | PERCENT OF STATE'S DOMESTIC BANKING DEPOSITS |
|---|---|---|---|
| Fleet Financial Group | Rhode Island | 5.28 | 55.7 |
| Bancorp Hawaii, Inc. | Hawaii | 5.36 | 43.6 |
| National Bancorp of Alaska | Alaska | 1.54 | 42.6 |
| U.S. Bancorp | Oregon | 7.77 | 37.8 |
| BankAmerica Corporation | California | 91.26 | 37.4 |
| First Hawaiian, Inc. | Hawaii | 4.58 | 37.3 |
| West One Bancorp | Idaho | 2.78 | 35.0 |
| Riggs National Corporation | District of Columbia | 3.32 | 32.8 |
| Shawmut Corporation | Connecticut | 8.70 | 32.7 |
| First Security Corporation | Utah | 3.18 | 31.5 |
| Valley National Corporation | Arizona | 9.28 | 31.2 |
| Barnett Banks, Inc. | Florida | 33.44 | 26.9 |
| BankNorth Group | Vermont | 1.36 | 28.3 |
| First National Bank of Alaska | Alaska | 0.91 | 25.1 |
| First Bank System | Minnesota | 11.29 | 24.6 |
| Bank of Boston Corporation | Massachusetts | 13.83 | 23.9 |

TABLE B–6 (continued)

| BANKING ORGANIZATION HOLDING OVER 20% OF DEPOSITS IN STATE | STATE | BHC'S DOMESTIC DEPOSITS IN THE STATE (IN BILLION OF DOLLARS) | PERCENT OF STATE'S DOMESTIC BANKING DEPOSITS |
|---|---|---|---|
| Norwest Corp. | Minnesota | 10.83 | 23.6 |
| Zions Bancorporation | Utah | 2.30 | 22.8 |
| Boatmen's Bancshares, Inc. | Missouri | 11.59 | 20.8 |
| Chemical Banking Corporation | New York | 53.45 | 20.7 |
| Chittenden Corp. | Vermont | 0.99 | 20.6 |
| Comerica, Inc. | Michigan | 15.65 | 20.2 |
| Wachovia Corporation | North Carolina | 11.33 | 20.2 |
| MNC Financial, Inc. | Maryland | 8.54 | 20.2 |

*PANEL B – BANKING ORGANIZATION IS AN OUT–OF–STATE OR FOREIGN BANK HOLDING COMPANY*

| BANKING ORGANIZATION HOLDING OVER 20% OF DEPOSITS IN STATE | STATE | BHC'S DOMESTIC DEPOSITS IN THE STATE (IN BILLION OF DOLLARS) | PERCENT OF STATE'S DOMESTIC BANKING DEPOSITS |
|---|---|---|---|
| BankAmerica Corporation | Washington | 12.33 | 36.1 |
| BankAmerica Corporation – | Nevada | 3.60 | 35.6 |
| Fleet Financial Group | Maine | 2.37 | 33.2 |
| First Interstate Bancorp | Nevada | 3.29 | 32.5 |
| BankAmerica Corporation | Arizona | 9.41 | 31.6 |
| Bank of Boston Corp. | Rhode Island | 2.90 | 30.6 |
| Citicorp | South Dakota | 3.25 | 29.1 |

TABLE B–6 (continued)

| BANKING ORGANIZATION HOLDING OVER 20% OF DEPOSITS IN STATE | STATE | BHC'S DOMESTIC DEPOSITS IN THE STATE (IN BILLION OF DOLLARS) | PERCENT OF STATE'S DOMESTIC BANKING DEPOSITS |
|---|---|---|---|
| First Security Corporation | Idaho | 2.26 | 28.4 |
| KeyCorp | Maine | 1.97 | 27.6 |
| Wachovia Corporation | South Carolina | 5.14 | 26.4 |
| First Interstate Bancorp | Oregon | 5.19 | 25.2 |
| Boatmen's Bancshares, Inc. | New Mexico | 2.76 | 25.2 |
| NationsBank Corporation | South Carolina | 4.83 | 24.9 |
| Fleet Financial Group | Connecticut | 6.37 | 24.0 |
| Fleet Financial Group | New Hampshire | 1.42 | 23.6 |
| KeyCorp | Wyoming | 1.00 | 22.8 |
| MNC Financial Inc. | District of Columbia | 2.29 | 22.7 |
| Banco Santander SA | New Jersey | 18.50 | 21.5 |
| First Interstate Bancorp | Arizona | 6.33 | 21.2 |

Sources: NIC Database, Reports of Condition and Income.

## APPENDIX B

### TABLE B–7

### AVERAGE THREE FIRM CONCENTRATION RATIO 1976–1992

| YEAR | METROPOLITAN STATISTICAL AREAS | NON METROPOLITAN COUNTIES |
|---|---|---|
| 1976 | 68.5 | 90.0 |
| 1977 | 67.9 | 89.9 |
| 1978 | 67.4 | 89.9 |
| 1979 | 66.8 | 89.7 |
| 1980 | 66.4 | 89.6 |
| 1981 | 66.1 | 89.4 |
| 1982 | 65.9 | 89.4 |
| 1983 | 66.0 | 89.4 |
| 1984 | 66.4 | 89.4 |
| 1985 | 66.7 | 89.5 |
| 1986 | 67.5 | 89.5 |
| 1987 | 67.7 | 89.5 |
| 1988 | 67.8 | 89.7 |
| 1989 | 67.5 | 89.7 |
| 1990 | 67.3 | 89.6 |
| 1991 | 66.7 | 89.3 |
| 1992 | 67.5 | 89.2 |

Source: Summary of Deposits, 1976–1992.

# PREPARED TESTIMONY OF SOPHIE M. KORCZYK, PH.D.

ANALYTICAL SERVICES, ON BEHALF OF THE
ALLIANCE FOR THE SEPARATION OF BANKING AND INSURANCE

OCTOBER 5, 1993

## SUMMARY

Mr. Chairman, I appreciate the opportunity to testify on S. 543 on behalf of Alliance for the Separation of Banking and Insurance. My name is Sophie Korczyk. I am an economist and consultant based in Alexandria, Virginia, and I specialize in the analysis of public policy and regulatory issues related to insurance and insurance products.

My testimony is based on research I have carried out under contract to the Alliance over the past five years and will address:

- economic arguments underlying the separation of banking and insurance; and
- dangers to consumers from permitting the erosion of the separation of banking and insurance.

## WHY SEPARATE BANKING AND INSURANCE?

Federally chartered banks and most State-chartered banks may generally not enter into affiliations or associations with other businesses. This separation is based on the premise that banks play a special role in the economy.

Some observers question whether banks should be subject to a different regulatory regime from that applied to other financial institutions. Banks can be considered special for several reasons. Banks are a major source of liquidity for the economy. Commercial banks serve as the "transmission belt" for monetary policy, creating money through their lending activities. Their assets are, therefore, illiquid while their liabilities are payable on demand.

These features are not unique. Other financial institutions extend credit, make and receive payments, and issue transaction or demand balances. What is unique about banking is that all three functions reside in one institution. It is this unification that creates special regulatory needs and requirements.

Nobel Laureate and banking specialist Lawrence Klein argues that banks' custody of privileged information about their clients is another features of banks that makes them different from other businesses.[1] Klein believes that the separation of banking from commerce is necessary to make sure that this information remains privileged and not subject to misuse by banks for their own benefit or that of their clients.

Even if it is agreed that banks are special, however, it is another task to decide the nature and degree of regulation this status justifies. Two of the important goals of bank regulation in this country have been protecting consumers through ensuring fair credit markets and preventing excessive bank concentration.[2] The separation of banking and insurance promotes the achievement of these goals.

## CONSUMER PROTECTION

A smoothly functioning economy requires an objective credit system that channels funds to borrowers based on economic merit. If credit markets are not objective, both depositors and borrowers can be disadvantaged. Depositors can receive lower returns since credit-worthy borrowers may be excluded. Borrowers, in turn, may be unable to finance viable enterprises.

Both banking supervision and the regulation of financial services in general are designed in part to avoid conflicts of interest. A relationship whereby a bank owns or is affiliated with an insurer or insurance product could invite such conflicts of interest. A bank may be unwilling to lend to competitors of its affiliates, or may establish higher standards for such borrowers than it does for other clients.

In addition to the possibility that competitors of banks' affiliates might lose their access to credit, both consumers and business borrowers could find that their costs of obtaining credit are higher if their bank or its affiliate also sells other financial services. Such increased costs could result from tying of bank credit to the purchases of other goods and services.

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[1] Lawrence Klein, *Banking Regulation in the Era of Financial Innovation* (Washington, DC: American Council of Life Insurance, 1988).

[2] Robert E. Litan, *What Should Banks Do?* (Washington, DC: Brookings Institution, 1987), Chapter 2.

### Tying and Coercion: Fact or Fiction?

The Bank Holding Company Act prohibits lenders from tying the receipt of credit to the purchase of other services or products. Some tying arrangements benefit the consumer. We generally prefer to buy cars with tires and cups with saucers. Other tying arrangements link products that do not need to be sold together. Furthermore, if the seller has market power in the tying market, such arrangements can foreclose competition in the market for the tied product.

Tying is sometimes confused with cross-selling, or the efforts of diversified vendors to interest consumers in the full range of their products or services. Airlines flying to Chicago, for example, generally advertise flights to exotic resorts. This is cross-selling. Cross-selling becomes tying if the seller permits one good or service (a flight to Aruba) to be purchased only if another (a flight to Chicago) is purchased as well.

Consumer advocates and bank deregulation opponents have expressed concern that expanded bank powers could broaden opportunities for coercive tying of credit to purchases of other goods or services sold by banks. Some of the disagreement over the possibility and incidence of coercive tying has stemmed from an inadequate understanding of the borrower-creditor relationship and the nature of the credit transaction. Two surveys provide information on these issues.

### Coercion is Possible

Some commentators argue that coercion in credit transactions is not economically possible. Both banks and nonbank lenders are numerous, it is argued, resulting in generally competitive credit markets offering a wide range of choice for borrowers. In such markets, a lender imposing onerous or unnecessary conditions on the extension of credit would lose potential borrowers to competitors who do not impose such conditions. Accordingly, lenders wishing to compete for qualified borrowers would not attempt to impose tying arrangements.

This argument ignores the effect of credit records on both borrowers' ability to avoid tying efforts and on competition among lenders. A credit refusal, for whatever reason, can complicate, if not foreclose, a borrower's future credit applications. If a borrower is denied credit for refusing to accept a tying arrangement, therefore, his recourse to the lender's competitors may be limited.

### How Tying and Coercion Occur

Coercion can be either implicit or explicit. Consumers perceive the credit setting as coercive. Accordingly, many feel that tying other transactions will improve their chances of receiving credit. A study by the American Council of Life Insurance (ACLI) found that close to half of consumers would open accounts at a bank or savings and loan association to improve their chances of obtaining a loan.[3] An additional 13 percent would not attempt to borrow from an institution where they did not already have an account.

Expanded bank powers could expand the scope of such implicit tying. An increase in tying could reduce competition in the provision of financial services by insulating lenders from competition on the basis of price, service, or quality.

Experience in the markets for credit insurance and title insurance provides two cases in point.

*Credit insurance.* Despite statutory prohibitions, overcharging and coercive tying arrangements in credit life insurance sales by lenders persist.

Explicit coercion in credit insurance sales can occur at two points: the decision to purchase credit insurance, and the choice of a vendor. Two Federal Reserve Board (FRB) surveys nearly a decade apart found that the share of borrowers purchasing credit insurance has remained steady at nearly two-thirds.[4] However, the share of low-income borrowers buying insurance rose by more than ten percentage points, while purchases among higher-income borrowers fell by more than thirteen percentage points. Some observers suggest that high rates of market penetration are proof of coercion. Changes in the pattern of credit insurance purchases could thus suggest that low-income groups are becoming increasingly vulnerable to high-pressure tactics.

Others argue that high purchase rates of credit insurance could reflect consumer preferences rather than coercion. In this view, coercion is more properly measured by the creditor's recommendations about the purchase of credit insurance. In the

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[3] American Council of Life Insurance (ACLI), *Monitoring Attitudes of the Public 1988* (Washington, DC: ACLI, 1988), pp. 53 and 57.

[4] Anthony W. Cyrnak and Glenn B. Canner, "Consumer Experiences With Credit Insurance: Some New Evidence," *Federal Reserve Bank of San Francisco Economic Review* 3 (Summer 1986), Tables 1 and 2.

more recent FRB study, more than 36 percent of consumers with credit insurance reported that the lender recommended, strongly recommended, or required credit insurance. Most borrowers surveyed felt that the extension of credit did not depend on their decision, but the study did not report separately the feelings of those subject to pressure.

In many States, however, creditors may legally require credit insurance. Pressure to buy insurance thus need not be improper, though the FRB surveys did not distinguish between States that did and did not permit such requirements.

Whether or not a lender may require credit insurance, it may not require the purchase of its own insurance. The more recent FRB survey strongly suggests, however, that lenders are using coercion to sell their own insurance. Nearly 90 percent of borrowers who reported that they bought credit insurance on their last credit purchase bought it from the lender.[5] More than half of these consumers report that they bought the lender's insurance because it was convenient and available.

Of those buying the lender's insurance, however, 8.2 percent felt they were required to buy insurance from the lender rather than another source, and 14.1 percent said the lender's insurance was automatically included with the loan, thereby foreclosing the borrower's chance to use another insurance source. Thus, up to 22.3 percent of borrowers who bought credit insurance from the lender appear to have been required to buy the lender's insurance. This total is equivalent to one in five of all credit insurance purchasers and nearly one in eight of all retail borrowers in 1985.

Even those consumers not experiencing coercion are not necessarily voluntary purchasers. In one survey, 40 percent of the retail credit customers responding did not know they had credit insurance even while they were paying for it.[6]

*Title insurance.* Similar problems have been documented in the title insurance industry. In several cases, savings banks that have acquired title insurance companies have proceeded to refer substantially all their borrowers' title insurance to those companies.[7]

Since many consumer borrowers willingly purchase credit insurance and virtually all real estate borrowers must purchase title insurance, the mere existence of coercive tying arrangements need not necessarily raise credit costs. Many observers argue, however, that the market clout of banks in selling insurance has contributed to a phenomenon known as "reverse competition." Insurers compete for bank business by offering lenders the highest possible commissions. As a result of reverse competition, credit life insurance sold through lenders' tying arrangements is about 40 percent more expensive than that sold independently of lenders.[8]

Current regulatory structures thus appear to be inadequate to police even the relatively limited insurance powers available to lenders. Allowing banks to sell a wide range of insurance products is likely to increase pressure on consumers to make decisions that may be counter to their best financial interests.

### Savings Bank Life Insurance

Savings Bank Life Insurance (SBLI) is sometimes used as an example of banks' ability to provide superior consumer service in insurance. I believe it is nothing of the kind. Three States—Connecticut, Massachusetts, and New York—allow savings banks to sell life insurance. These States provide State-level funds that allow risk-pooling among savings banks on a Statewide basis and guarantee or reinsure all SBLI policies.

SBLI is a specialized product. It is subject to restrictive limits on policy face value. It accounts for about 3 percent of the insurance in force in these States, and the conduct of eligible banks in selling this insurance has not been studied.

## Concentration and Competition in Financial Markets

Competition is a major focus of deregulation debates. Advocates of expanded bank powers argue that allowing banks to enter other financial markets would enhance competition, benefiting consumers and society through lower costs for financial services. Opponents of expanded bank powers argue that the competitiveness of the in-

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[5] Cyrnak and Canner, Table 3.

[6] See, for example, letter of Lewis H. Goldfarb, Assistant Director for Credit Practices, Federal Trade Commission, to Sen. William Proxmire, February 5, 1979, p. 3.

[7] Joyce D. Palomar, "Bank Control of Title Insurance Companies: Perils to the Public That Bank Regulators Have Ignored," *Southwestern Law Journal* 44 (Fall 1990): 905–942.

[8] National Association of Insurance Brokers et al., *In the Matter of the Board of Governors of the Federal Reserve System's Proposed Elimination of the Rate Reduction Requirement from Its Credit Life and Credit Accident and Health Insurance Underwriting Regulation,* January 24, 1984, p. 20.

surance market, as well as financial markets in general, is likely to decrease, with adverse results for consumers.

Excessive bank concentration could exclude whole classes of otherwise credit-worthy borrowers, give banks too much political power, and promote system instability. Greater concentration does not necessarily enhance the performance of either the banking system or the economy.[9]

The decline in the share of the Nation's financial assets held by commercial banks has been well documented. Banks held 31 percent of all-financial assets in the second quarter of 1993, down from nearly 38 percent in 1980. Despite this decline, however, banks are still major players in the provision of consumer financial services. For example, commercial banks hold more than twice the assets of all life insurance companies and more than six times the assets of all property and liability companies. The banking system is also more concentrated than the insurance industry and the ongoing shakeout in commercial banking is likely to increase this concentration.

Allowing banks to sell insurance would increase concentration in the financial services sector. Large banks would seek out large insurers or insurance agencies for partnerships. Competition in insurance would decline, as the agencies associated with large banks would have greater market clout. With reduced competition, customer service would decline as well.

## CONCLUSIONS

It is my understanding that the Committee expects to mark up legislation related to the insurance activities of national banks, as well as other matters, later this year. S.543, passed by the Senate on November 21, 1991, limits banks' ability to engage in insurance activities in several ways. Section 704 of Title VII, which limits the insurance activities of national banks, provides special treatment for banks in certain States, but limits bank insurance activities in small towns.

The condition and conduct of the U.S. banking system is important to all Americans. I believe these provisions enhance the competitiveness of both banks and insurers. These provisions would permit banks to engage in insurance activities in selected States and communities where competitive conditions so indicate. They would, however, maintain the basic separation of banking from insurance, which I believe should continue to stand.

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## PREPARED STATEMENT OF JAMES M. CULBERSON, JR.

### ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Committee, I am James M. Culberson, Jr., Chairman and CEO of First National Bank & Trust Co. in Asheboro, North Carolina. I am a member of the Board of Directors of the American Bankers Association, and Co-Chairman of ABA's Government Relations Council. The member organizations of the American Bankers Association range in size from the smallest to the largest banks, with 85 percent of our members having assets of less than $100 million. The combined assets of our members comprise about 95 percent of the total assets of the commercial banking industry.

The American Bankers Association appreciates the opportunity to testify before this Committee on interstate banking and branching and insurance sales by banking institutions. These are issues of great importance to the banking industry, and they are issues on which bankers have very strong opinions.

In my statement this morning, I would like to talk about some of these opinions and discuss how the position of the American Bankers Association has evolved over the past few years. But before beginning this discussion, let me give you our bottom line:

- We support the basic approach to interstate banking and branching contained in legislation passed by the Senate in 1991. This provision allowed individual States to "opt-out" of the Federal interstate banking and branching law, if they choose to do so, by a vote of the State legislature; and it protected the rights of States to determine the method of initial entry by which out-of-State banks may enter their market.
- ABA strongly opposes any effort to restrict the sale of insurance by banks, and ABA will oppose any bill that includes such a provision. To move backwards by

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[9] Lawrence R. Klein, "Policy Making in Global Financial Markets," Speech given at Global Interdependency Conference, Philadelphia, June 15, 1987.

adding further restrictions on banks' ability to sell insurance products would hurt our customers and our industry. Sale of insurance is a riskless activity which poses no threat to the FDIC Bank Insurance Fund. In short, restricting banks from participating in insurance sales serves no purpose other than to protect certain sectors of the insurance industry from competition.

My statement today is divided into three sections. The introduction provides an overview of the ABA's position on interstate banking and branching and restrictions on insurance sales. The next two sections present a more detailed background discussion of these two issues.

I. Introduction—Summary of ABA Position

As the Members of this Committee are well aware, interstate banking has historically evoked a wide variety of views within the banking industry. Several years ago, as the Congress showed more and more interest in actively considering legislation to phase in full interstate banking and branching, the ABA undertook a comprehensive review of the issue to see if some common solution could be proposed by the industry. In undertaking this review, we worked closely with the State bankers associations.

The critical factor revealed by our review is that, for all intents and purposes, interstate banking is already a reality. In fact, there is now only one State that does not have some type of interstate banking law, and well over two-thirds of the States permit full interstate banking. Several States are now taking the additional step of permitting interstate branching through State legislative action.

Prior to the consideration of FDICIA, the ABA adopted a position that stated the Association would support a phasing-out of Federal restrictions on interstate banking and branching, as long as two criteria were met. First, individual States should have the right to "opt-out" of the system by action of the State legislature. Second, State laws which govern the method of initial entry of out-of-State banks should be protected; for example, a number of States permit out-of-State banking institutions to enter their State initially only by the acquisition of an existing bank in that State.

This position has the support of a great majority of bankers and State associations. ABA's Board of Directors recently revisited the interstate banking and branching issue, and confirmed that the ABA would support legislation meeting these criteria, *as long as it was not encumbered by other negative provisions.*

The language on interstate banking and branching that passed the Senate in 1991, which contained Senator Wendell Ford's amendment, is consistent with the ABA's position on this issue. (Senator Ford has introduced legislation substantially similar to his 1991 amendment again this year.) The 1991 provision permits the phase-in of interstate banking and branching, while allowing individual States to opt-out and also protecting State laws with respect to the method of initial entry.

Since the Senate passed the bill in 1991, there have been on-going discussions about the details of the language within the banking industry and among policymakers. As a result of these discussions, there may be some technical improvements that can be made to the language which passed the Senate. We would be pleased to work with the Committee and other interested parties to obtain the best possible legislative language.

On the second topic of these hearings, imposing restrictions on bank insurance activities, the message from bankers is loud and clear—we are strongly opposed to the restrictions on the insurance activities of banking institutions which were contained in the 1991 Senate-passed bill.

Since there has been some discussion of combining insurance sales restrictions with interstate banking and branching in one legislative vehicle, ABA's Board of Directors considered this possible linkage at its most recent meeting. The Board voted to take a strong position against any such linkage. Simply put, *we will strongly oppose any bill which contains new restrictions on the insurance activities of banking institutions.* The ABA has been authorized to inform you that we are joined in this position by the Association of Reserve City Bankers and the Consumer Bankers Association.

There are three primary reasons for our opposition to the 1991 Senate language on insurance sales, and indeed, to any new restrictions on our ability to sell insurance. *First, such restrictions totally ignore the dramatic changes that have taken place in financial markets. For years now, this Committee has heard testimony on the increasing integration of financial products and services being undertaken by non-bank providers. Yet once again, some are advocating imposing additional restrictions on the banking industry.*

Mr. Chairman, these efforts look to us like an effort to hold the banking industry in the 1950's while the rest of the financial world moves into the 21st century.

Banks will not be the only losers if these attempts are successful; bank customers—and all consumers of financial services—will also lose access to affordable financial products that result from market-driven competition. As will be discussed in more detail below, consumer group studies have shown that banking institutions often provide better service, lower costs, and wider availability than traditional insurance agents.

The most recent example of the direction in which financial markets are moving is the merger announced by Primerica and Travelers Insurance. While this Committee is holding hearings on imposing new restrictions on the ability of banks to sell insurance, these two large companies, joined together, are able to mix insurance, banking and securities, as well as a whole host of other financial services, in one giant financial corporation. Indeed, it is particularly ironic that the resulting conglomerate will itself own an FDIC-insured bank.

*Second, banks are the only providers of credit that are limited in their ability to sell insurance.* Although a large number of banks do sell some types of insurance through various provisions in Federal law and under certain State laws, significant restrictions prevent banks from providing a full line of insurance products to their customers. There is no justification for discriminating against banks—and bank customers—in this fashion.

Those who would restrict banks from selling insurance argue that control of credit should not be linked to providing insurance. If this argument has merit, then why are there no restrictions on combinations of credit granting and the sale of insurance products from non-bank providers? Savings and loans, credit unions, mortgage companies, finance companies and other lenders—like Primerica—can all be associated with insurance agencies and offer combinations of banking and insurance products—but not commercial banks. Why is it that banks are singled out? There can be no other reason than the fact that bank competitors are interested in protecting their own share of the market. Mr. Chairman, we believe that consumers deserve the benefits of greater competition, not less as some sectors of the insurance industry would prefer.

If there is a problem with combining insurance sales and lending—and there is scant evidence that such a problem exists—it is certainly not peculiar to banks. As a banker, I compete every day with many non-bank providers, all of whom can grant credit and sell insurance. I certainly have no more ability to tie the sale of insurance to the granting of credit than any of these other lenders, many of which are larger and more powerful than my bank. If there is a perceived problem, it should be dealt with through consumer protections equally applicable to all credit-grantors, not just banks.

Proponents of limiting bank sales of insurance also allege that such activities are a threat to the safety and soundness of the FDIC Bank Insurance Fund. This argument is totally without merit. Selling insurance is an agency activity which poses no risk to the bank. Quite to the contrary, selling insurance broadens the earnings base of banks, making the industry stronger and helping to protect the FDIC fund. Indeed, there are examples of banks in the mid-west during the 1980's agricultural crisis which might have failed if they had not had continuing income from insurance sales. As you know, State chartered banks in many States have sold insurance under State laws for many years.

The argument that insurance sales and Federal deposit insurance do not mix also fails to recognize that savings and loans and credit unions are federally insured, yet both these types of institutions have broad authority to sell insurance. Why it is all right for a savings and loan (which now calls itself a bank and advertises that it is FDIC insured) to sell insurance but not all right for a bank to do the same thing? Why is it all right for a credit union with a community-wide common bond to sell insurance, while a bank cannot?

*The third, and perhaps the most important, reason why bank sales of insurance should not be restricted is the current concern about the availability and price of insurance services.* In State after State, the availability and cost of insurance products are among the top consumer issues. For example, these issues are receiving a great deal of attention in southern Florida and Hawaii because of hurricane damage, as well as in such States as California and New Jersey. The lack of insurance availability in our inner cities is also receiving considerable attention, not only at the State and local level, but in the Congress. A great deal was written after the riots in South Central Los Angeles about the lack of availability of insurance and the very negative impact that had on economic opportunity in those areas. When individuals and businesses cannot obtain insurance, they often cannot qualify for the loans they need to buy a home or to keep their businesses going. It simply makes no sense to limit any provider from selling insurance when the need is so great.

Mr. Chairman, let me add one more thought that deals with the *context and timing* of this discussion of bank insurance activities rather than the *merits* of the arguments. The ABA believes that the issue of insurance sales authority for banks should not be dealt with in isolation, but rather should be considered in the context of an overall Congressional review of financial services industry law and regulation. Otherwise, we run the risk of piecemeal and inconsistent action.

Let me give you a real life example of the market impact such piecemeal actions can have. While this Committee is holding a hearing on imposing new restrictions on bank insurance activities, an amendment was recently filed for Committee markup consideration that would remove the seven percent annual growth-cap restriction on non-bank banks. What would enactment of this amendment mean? It would mean that insurance companies, securities firms, and many non-financial firms that own FDIC-insured non-bank banks would be free to market combinations of financial products—including banking products—with virtually no restrictions. Commercial banking institutions, however, would be saddled with even more restrictions on their ability to sell insurance. In other words, the proposed amendment on non-bank banks goes in exactly the opposite direction of the Senate's 1991 provisions on insurance sales by banking institutions.

II. INTERSTATE BANKING—A CURRENT REALITY

The ABA believes it is time for Congress to adjust existing Federal banking law to more closely reflect the realities of today's evolving competitive market place. Changes to Federal law such as the interstate provisions passed by both the Senate and the House in 1991 would ensure that a uniform, orderly system of interstate banking and branching would be put in place, while retaining appropriate authority for the States.

Mr. Chairman, interstate banking is already a reality. Only one State—Hawaii—does not now permit some form of interstate banking. The other 49 States and the District of Columbia have adopted some form of national or regional interstate banking.

Twelve States (Alaska, Arizona, Colorado, Idaho, Maine, Nevada, New Mexico, Oklahoma, Oregon, Texas, Utah, and Wyoming) have nationwide non-reciprocal laws, meaning that they (the "host" State) permit entry by banks from other States (the "home" State) even if the home State does not allow entry into its market. Twenty-two States (California, Connecticut, Delaware, Illinois, Indiana, Kentucky, Louisiana, Massachusetts, Michigan, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Dakota, Tennessee, Vermont, Washington, and West Virginia) have nationwide reciprocal laws which allow entry by banks from States which allow reciprocal entry into their jurisdictions.

Fifteen States (Alabama, Arkansas, Florida, Georgia, Iowa, Kansas, Maryland, Minnesota, Mississippi, Missouri, Montana, North Carolina, South Carolina, Virginia, and Wisconsin) and the District of Columbia have reciprocal regional statutes, meaning they will allow entry by banks from designated States which allow entry for their banks. In 1996, North Carolina's regional reciprocal law will convert to national reciprocal status, and a number of other States are expected to adopt nationwide laws in the near future.

I have attached a detailed listing of the legal status of each State which outlines the terms and conditions applicable to interstate banking. You will note that many States currently require out-of-State bank holding companies to acquire existing institutions as a condition to initial entry into the State.

*Interstate Branching*

Many bank holding companies have taken advantage of the growth of interstate banking to establish a banking presence in States which permit such entry. However, with few exceptions, existing law currently prohibits banks and bank holding companies from branching interstate. Since 1992, New York, North Carolina, Oregon, and Alaska have acted to remove current barriers to direct interstate branching by State-chartered non-Federal Reserve member banks. Interstate branching was already possible in limited circumstances in Maine, Nevada, and Rhode Island. Even without Federal action, it is likely that a number of additional States would move to the interstate branching concept.

*Senate-Passed Version of Interstate Banking and Branching*

As stated earlier, the ABA believes that the Ford Amendment to S. 543 which was passed on the floor of the Senate in 1991 contains a workable approach to establishing a system of interstate banking and branching. The amendment would allow bank holding companies with interstate operations to eliminate various redundant administrative functions if they choose. At the same time, the amendment would

protect the valuable role of the States in determining whether and in what format banks and bank holding companies could operate within its borders.

The ABA, working closely with State banking associations across the country, supported the Ford Amendment on the Senate floor during debate over FDICIA in 1991. (ABA also supported a similar amendment offered by Congressmen Vento, Wylie, and Bereuter in the House which passed by a vote of 366 to 4.) While certain peripheral questions from 1991 may need further refinement, the ABA believes that the Senate-passed language of 1991 contained the core elements of an acceptable interstate banking and branching approach.

Whatever form of interstate branching Congress may enact, its principal effect would simply be to let existing interstate banking organizations convert separate banks into branches. The status of those offices as banks or branches has absolutely nothing to do with their legal ability to sell insurance. Therefore, there is no logical linkage between the issues of interstate branching and the ability of banks to sell insurance.

### III. Banks and Insurance Sales—There Should Be No Restrictions

Time travelers from the 1950's would have trouble recognizing today's financial services market. Consumers can "bank" with Merrill Lynch; insurance companies and telephone companies are major players in the credit card market; and home-buyers can get a mortgage loan from a variety of companies ranging from Prudential Insurance to General Motors.

In the 1990's, the line dividing banking from other financial activities, including insurance and securities, exists only in theory—in practice, it has been overrun by market forces. Affiliations such as the merger discussed below between Primerica and Travelers, both of which own federally insured depository institutions, have become commonplace occurrences. These new financial mega-firms offer innovative combinations of services that are re-defining the market for financial products. Meanwhile, banks remain hamstrung by outdated laws that prevent them from participating as equals in these important new financial markets.

Let's take a closer look at the most recent example of what is happening in the marketplace—the merger of Primerica and Travelers. A few weeks ago the Primerica Corporation announced it would merge with the Travelers Corporation, with the resulting financial services firm retaining the Travelers name. The resulting Travelers company will be one of the Nation's largest financial services firms, with more than $100 billion in assets and $10 billion in equity. Sanford Weill, Primerica's Chairman and CEO, stated that the merger will create "Dominant positions and strong brand franchises in four major businesses—insurance, securities brokerage, asset management, and consumer lending" and will thereby help to ensure "a more diversified earning stream" (*National Underwriter*, September 27, 1993).

What do these two companies now consist of? Primerica includes Smith Barney Shearson, the Nation's second largest stock brokerage firm with more than 10,500 employees operating across the United States, as well as active investment banking operations. Primerica Financial Services (PFS) is a major insurance company whose 100,000 member sales force actively markets both insurance and mutual funds. Its final component is its consumer finance arm, the Commercial Credit Company, which engages in consumer lending through about 700 branches located in 40 separate States, and which operates the FDIC-insured Primerica Bank, a major credit card issuer.

Travelers, the Nation's fourth largest stock insurance company, consists of five separate divisions—financial services, property-casualty personal lines, property-casualty commercial lines, managed health care and employee benefits, and asset management and pension services. Travelers includes among its activities active involvement in consumer banking.

To sum up, the resulting Travelers corporation will be a giant financial services firm active in stock brokerage, investment banking, the underwriting and sale of both life and property-casualty insurance, investment management, health care management, and consumer lending encompassing the operation of an FDIC-insured bank and the maintenance of a 40-State branch lending network. I don't think there can be any doubt that if the name of this combination was changed to Citibank, or First Chicago, or Bank of America, or any other commercial bank, today's witnesses from the insurance industry would be arguing strongly for legislation to prevent the consummation of this merger. But since it's a non-bank financial services company, despite its ownership of an FDIC-insured bank, all the supposed horrors which our critics maintain flow from such combinations will go unmentioned. Nor will you hear them argue for new laws to prevent Primerica's and Travelers' insurance

agents from being able to provide their clients with all manner of credit and products.

There is absolutely no dispute that Primerica and Travelers, separate and merged, are and will actively engage in the cross-marketing of credit and insurance. Primerica Bank already markets its credit cards to customers of Primerica Financial Services and to clients of Smith Barney Shearson. And Primerica Financial Services actively markets mutual funds, home equity loans, and personal loans to its insurance clients. Travelers is already actively involved in consumer banking. And new cross-selling opportunities will undoubtedly be explored, *with a pilot program already being considered to promote the sale of Travelers' homeowners insurance to borrowers from Commercial Credit.* Why should a mortgage borrower from Commercial Credit be given the opportunity to simultaneously insure their home if such business combinations are deemed to be unconscionable when the lender is a bank?

Unlike our critics, we are not here today to argue that such business combinations or the resulting cross-marketing opportunities are inherently evil. Indeed, so long as customers are fully informed about each of the separate products and are free to buy one without purchasing the other, they are beneficial.

Isn't it time for this Congress to recognize that this is the real competitive environment for commercial banks, and for that matter, for independent insurance agents, today? Prohibiting banks and insurance agents who want to join together, as they have in dozens of cases under State law, does nothing to prevent legitimate cross-marketing from being conducted by firms like Primerica/Travelers. What it does do is make it more difficult for both banks and in many cases for insurance agencies to compete and it deprives their customers of opportunities for convenience and cost savings.

This merger is not an isolated example of what is going on in financial markets. Let's look at a few others.

- PRUDENTIAL, the largest life insurance company in the country, owns Prudential Securities, the ninth largest securities firm; the Prudential Bank and Trust Company and Prudential Savings Bank, F.S.B., both FDIC-insured depository institutions; and Prudential Residential Services, a large real estate firm with a national presence. Through this network, the company offers FDIC-insured deposits, credit card services, retail securities and commodities brokerage, mutual funds, securities underwriting, insurance sales and underwriting, and real estate brokerage and investment services. The consolidated assets of The Prudential totaled $199.6 billion at year-end 1992.
- MERRILL LYNCH, the largest securities firm in the country with client assets of more than $500 billion (2.4 percent of all U.S. financial assets), owns Merrill Lynch Bank and Trust Company, an FDIC-insured bank; Merrill Lynch Insurance Group, Inc. with $13 billion in insurance assets; and Merrill Lynch Asset Management, the second largest mutual fund company, which manages mutual funds and provides investment advisory services. Through this network, Merrill Lynch offers FDIC-insured deposits, a wide range of securities services such as money market funds, mutual funds, and cash management services for both businesses and consumers. Merrill offers debit/credit cards and retail and corporate lending services, and is involved in both underwriting and sales of insurance and annuity products. The consolidated assets of Merrill Lynch totaled $103.6 billion at year-end 1992.

It is not just securities firms and insurance companies that are offering attractive combinations of financial products. General Electric and Ford Motor Company, for example, began as nonfinancially-based companies. But while their public image remains associated with light bulbs and automobiles, the fact is that these companies—and many other "non-financial" companies—are very involved in the provision of financial products to both businesses and consumers.

The following are some examples of the financial activities of "non-financial" firms:

- GENERAL ELECTRIC CORPORATION owns General Electric Capital Services with total assets of $154.5 billion. GE is one of the largest commercial lenders in the country, providing equipment leasing, loans, asset financing, asset management, and real estate financing; GE is the ninth largest issuer of credit cards (private label) with 65 million accounts. Employers Reinsurance is the second largest property and casualty reinsurance company in the country. Kidder, Peabody is the largest underwriter of mortgage-backed securities, and was among the largest underwriters of debt and equity securities in domestic and world markets.
- FORD MOTOR COMPANY, the second largest domestic auto manufacturer, owns Ford Financial Services with total assets of $115 billion. Ford Financial owns First Nationwide Bank, FSB, one of the largest federally-insured savings institutions in the country, with $18 billion in assets; Associates, the sixth largest fi-

nance company in the country; Ford Motor Credit, the third largest finance company in the world; and U.S. Leasing, one of the country's largest and most diversified organizations in equipment and facilities leasing. Ford Financial (through Associates) is in the top 10 issuers of credit cards, is among the largest mortgage originators, and is one of the top five consumer lenders in the country. While auto-financing was originally the base of Ford's lending business, today some 60 percent of the financial receivables of First Nationwide, Associates, and Ford Motor Credit are not auto related. Ford also underwrites and sells insurance through two insurance companies owned by Ford Motor Credit.

These examples reflect just how great a sea change has taken place in financial markets. The question of whether or not to mix banking, insurance, and securities activities has been answered by the marketplace—these combinations already exist, not just in isolated instances, but in major, growing components of the financial services industry.

The question policymakers must ask themselves today is whether commercial banks will be permitted to catch up with other financial service providers in a manner which benefits consumers, enhances competition, and strengthens the overall financial system. The lack of adequate access to insurance products in many areas of the country makes the answer to this question very important to consumers.

*Customer Benefits of Bank Involvement in Insurance Sales*

Mr. Chairman, in a recent speech, Comptroller of the Currency Eugene Ludwig laid out two tests by which new bank products and services should be judged: first, new products should not cause safety and soundness problems; and second, new products should benefit consumers of financial services. There is no doubt that allowing banks to sell insurance meets both of these criteria—conversely, there is no doubt that further restricting bank sales of insurance would hurt safety and soundness and deprive consumers of the potential benefits of increased competition.

Comptroller Ludwig stated:

> To my mind, the argument that selling insurance creates safety and soundness problems for banks simply lacks credibility, while the argument that selling insurance would benefit consumers seems virtually self-evident. Yet bank sales of insurance remain significantly restricted.
>
> Over the long haul, locking banks away from opportunities to engage in safe and sound financial services activities tends to reduce both competitiveness and safety and soundness, and, by reducing the range of products and services from which consumers may choose, impoverishes our marketplace and our economy.

Many consumer groups also support broader bank involvement in the sale of insurance products. These groups recognize that there are significant consumer benefits to be gained from bank entry including lower costs, more convenient service, and better product and cost information. In addition, banks can reach out to a broader spectrum of consumers, making insurance products accessible to more people.

For example, a study done for the Consumer Federation of America in 1987 found that the present life insurance system imposes excess annual costs on consumers, and that bank entry has the potential to save consumers $5 to $10 billion per year in life insurance sales alone. The CFA study included a nationwide survey of insurance sales practices and found that "banks are more responsive to consumer requests for information" than captive or independent agents. The study reported that ". . . every one of the [survey] comparisons shows that bank's sellers of life insurance were more forthcoming with information than agents . . . the policies sent by bank-based sellers were much lower in cost."

This Consumer Federation of America study is not the only indication that bank entry into insurance sales could benefit consumers. Robert J. Hunter, President of the National Insurance Consumer Organization, said in testimony before this Committee: "Banks are a logical source of insurance. Sales outlets in banks would be convenient for consumers and should be extremely efficient points for sale. The incredible reaction of insurance agents against bank entry is due in the main to their inefficiency and high cost."

Consumer group support has been crucial to the enactment of bank insurance sales powers in several States including California and Virginia. For example, the Virginia Citizens Consumer Council (VCCC) was one of the strongest proponents of the authorizing legislation recently signed by Governor Wilder. I would like to quote from testimony presented by Jean Ann Fox, President of VCCC, before the Virginia Senate Commerce and Labor Committee on February 26, 1990:

Virginia Citizens Consumer Council supports H.B. 335 to permit banks to sell insurance. We believe that this bill balances the need for greater competition in the sale of insurance with the important goal of safeguarding consumers.

The artificial barriers between insurance companies and financial institutions are already crumbling, with insurance companies acquiring banks and offering financial services. . . . My insurance carrier is offering to loan me money. My bank is offering to sell me insurance. This bill simply recognizes the trend to financial supermarkets.

VCCC is actively involved in trying to improve the competitiveness of the insurance market. . . . We look on H.B. 335 as one more measure to improve competition at the retail sales level by increasing the choices for consumers.

Banks can achieve cost savings in part because the network of banks and branches almost 64,000 office locations across the country—gives banks an ideal delivery system for retail insurance products. Bank expertise in administrative functions and data processing technologies will contribute significantly to lower insurance costs. And the convenience of bank branches will make consumer access easier and more efficient.

Banks can also provide an increase in overall service levels. This can be especially important for lower income households because banks have relationships with nine out of ten households with annual incomes of less than fifteen thousand dollars. This market segment has not been well served historically by the insurance industry, with only seven percent of life policies insuring individuals with incomes of less than ten thousand dollars. The modest, low commission term life policy that is most suitable for such an individual is not a product which many insurance agents will devote their marketing time to because of the high cost of individually prospecting customers; however, such products can be distributed very efficiently through banks.

Banks also can enhance the overall availability of good product and cost information, as was demonstrated by the Consumer Federation of America study mentioned above. Consumers will not only save money by selecting the product best suited to their needs, but their broader knowledge of available products, suppliers, and prices is a strong antidote to anti-competitive market practices.

*Bank Sales of Insurance Poses No Safety and Soundness Risks*

Mr. Chairman, as you well know, some banks are already involved in many aspects of insurance sales—without any evidence of safety and soundness problems. At present, fifteen States authorize general insurance agency activities for their State-chartered banks, with California, Delaware, and Virginia being the most recent States to pass enabling legislation. An additional thirteen States permit their banks located in small towns to sell insurance. And Connecticut, Massachusetts, and New York permit the sale of savings bank life insurance, which has long been recognized by consumer groups as one of the best life insurance product values available. Altogether, more than half the States already permit their State-chartered banks to engage in the sale of insurance beyond credit-related insurance.

A report issued by the insurance consulting firm of Conning and Company found that fully eighty percent of the largest commercial banks now offer annuities and fifty percent offer other traditional life insurance products; among the largest savings associations, fully ninety percent own insurance agencies. Overall, more than twenty percent of U.S. commercial banks and more than fifty percent of savings institutions now have insurance operations. As the Conning and Company report concludes, "It is now clear that banks are in the insurance business to stay."

In late 1990, the General Accounting Office (GAO), the Congress's investigatory arm, released a new and extremely comprehensive report discussing all the salient policy issues raised by the sale of insurance by banks. This September 1990 study, "Bank Powers—Issues Relating to Banks Selling Insurance," is the most exhaustive third party study of this subject that we are aware of. The GAO spent more than one year in its research and analysis. They consulted with grandfathered bank holding companies, banking industry organizations, insurance agent and underwriter trade associations, insurance companies, consumer organizations, and academic and independent experts.

The GAO study refuted virtually all the major arguments used by the insurance industry in protest against potential bank entry into insurance sales. It found real opportunities to reduce consumers' cost of purchasing insurance; it found no significant safety and soundness risks, no consumer coercion problems which cannot be ameliorated through appropriate regulation and other safeguards, and no unfair or unique competitive advantage vis-a-vis other insurance providers.

In fact, the GAO conclusions reinforce all of the points the banking industry has raised over the years in its testimony on this subject. The GAO report continues a long string of impartial, third party studies which found substantial potential

consumer benefits from bank insurance sales and no strong countervailing reasons to prohibit such activities. In fact, not surprisingly, the only studies we are aware of which have come up with contrary findings have been those directly funded by the insurance industry.

Not only did the GAO study find that bank sales of insurance present no safety and soundness problems, it concluded that the fee income from such activities can actually *enhance* safety and soundness. In fact, the fee income derived from low or no-risk insurance sales activities will directly benefit consumers as both customers and taxpayers because it will strengthen the overall banking system and increase its competitiveness in the modern financial marketplace.

GAO also found that consumers can expect some reduction in cost and significantly increased convenience from bank entry. GAO noted that potential for conflicts of interest and abuses exist for all insurance sellers, including large insurance companies as well as all other lenders now able to engage in insurance sales. It observes that regulatory overkill directed at such potential conflicts and abuses could negate the potential consumer benefits. In this regard, ABA's position has been that any statutory consumer protections should apply across the board in regard to all sellers of insurance, particularly those which cross-sell other financial products and services, and should not apply exclusively to banks. We also believe that protections which are of a disclosure nature would be generally acceptable, but that more pervasive structural barriers (such as prohibiting cross-selling and/or requiring physically separate offices) needlessly diminish the competitive benefits of bank entry and are not required for safety and soundness or consumer protection.

Banks are clearly in the insurance business to stay. California and other States have taken the lead in recognizing the potential consumer benefits and potential benefits to the banking system which can result from these activities. Consumer groups have been vocal in providing critical support to the State initiatives. Every impartial inquiry, including the recent GAO study, has concluded that insurance sales is an extremely low-risk, fee-income activity which can strengthen the banking system while providing consumers with substantial cost savings and increased choices and convenience. Consumers clearly have much to gain from banking institution sales of insurance.

*Consumer Protections*

The ABA recognizes that certain protections may be necessary to ensure that consumers are not misled about the products they purchase or forced to obtain other services as a prerequisite to obtaining credit.

Many of these protections, at least for the banking industry, already exist. For example, Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C 1972) prevents consumers from being required to purchase other corporate products as a condition of obtaining a bank product. Such illegal "tie-ins" would subject violators to substantial damages.

However, we believe it is important that Congress impose consumer protections standards to all providers of similar financial services. Combining Prudential Insurance Company with an FDIC-insured bank raises the same issues as combining Citicorp with an insurance underwriter. Anyone can own an S&L—witness Ford owning First Nationwide—and sell insurance, securities, and other financial services in combination with a federally-insured institution. Bank-like products are being offered by a host of "non-bank" institutions. Yet these companies are not subject to the same types of regulatory concerns and administrative burdens that banks now face, or that are being proposed to accompany new authorities for banks. We believe this dual standard raises important consumer protection concerns.

The banking industry stands ready to work with legislators to construct appropriate safeguards which would adequately address the consumer's need for protection while not negating the consumer benefits of bank insurance sales. But these safeguards should be applied even-handedly to all financial services providers.

*Illegal Tie-In Sales*

The principal charge that we hear over and over from the insurance lobby in opposition to bank entry into insurance activities is that banks will supposedly use their market power as lenders to coerce customers into purchasing insurance products and services which they do not want as a precondition of obtaining a loan.

The simple fact is that banks do not have the market power to enforce such coercive arrangements—consumers have far too many choices of providers of financial services to be coerced into buying a bank product. In fact, in lending market after lending market, banks have smaller and smaller market share. And in the great majority of geographic markets, individual banks are competing with larger and more powerful non-bank lenders which can sell insurance. Further, banking institu-

tions, and banking institutions alone, are subject to both specific statutory prohibitions regarding tying activities as well as the general antitrust laws.

Furthermore, it is hypocritical for some insurance organizations to assert that banks will engage in coercive tying when those same organizations have testified against legislation which would subject insurers to the basic antitrust laws, including prohibiting tying arrangements which are now regularly engaged in with impunity by insurers because of the failure of the antitrust laws to fully encompass their activities.

Both the antitrust laws and additional bank-specific Federal laws prohibit price fixing, territorial allocation with competitors, coercive tying, and monopolizing on the part of banks. Clearly, these same anti-competitive practices should be explicitly prohibited for insurers by Federal law. Consumers would benefit greatly if such practices were prohibited.

*No Need for Precipitous Action*

Mr. Chairman, the insurance industry witnesses appearing before this Committee would have you believe that the D.C. Court of Appeals (which held that the Comptroller of the Currency was correct in his interpretation of the 1916 law allowing banks to sell insurance from towns with a population of less than 5,000) has opened a gaping "loophole" which, if not closed immediately, will have dire consequences. Therefore, they have asked this Committee to act now, in advance of any attempt to secure Supreme Court review.

Let's look at the record. First, the Court of Appeals decision was no great surprise. Second, there remain a number of legal uncertainties regarding the ability of national banks to sell insurance and annuities which will continue to inhibit bank expansion. Third, any action by this Committee should await consideration of a coherent blueprint for changes to the financial services landscape. Finally, any precipitous action by Congress carries with it a threat of striking a significant economic blow not only against banks but against life insurance companies.

Let me elaborate on each of these points.

First, the decision is no great surprise. The Supreme Court has now settled the issue that, for more than 75 years, the National Bank Act has authorized national banks and their branches located in small towns to sell insurance. The provision has never contained any geographic restriction. In the mid-1980's, when new technology and marketing practices made it feasible to consider selling insurance on a broader basis from these small town agencies, the Comptroller correctly held that there was no geographic limit to this authority, a ruling upheld by the District Court and Court of Appeals. It is, of course, impossible to know what Congressional intent was in 1916 because that Congress could in no way have envisioned today's marketplace. No industry could survive being locked into a product market defined during World War I. The Comptroller had ample authority to interpret the 1916 language the way it was interpreted.

Second, despite the holding of the D.C. Court of Appeals that the OCC was correct in its statutory interpretation, there still remains considerable legal uncertainty regarding the manner in which national banks may utilize this small town insurance authority. The OCC is fielding questions from many banks regarding its practical implementation. It is not at all clear to what extent national banks may utilize agents or representatives in locations outside towns of 5,000 to market insurance. Further, based on past experience, there can be little doubt that any OCC guidelines which permit various marketing techniques in larger communities will probably face further court challenge by insurance industry plaintiffs.

However, on one point there can be little doubt. Despite the OCC's opinion that, as a matter of law, national banks are not obliged to obtain State insurance licenses to market insurance or related products, as a practical matter bank agents must be licensed the same as any other insurance agent. This is true because State insurance commissioners would come down hard on any insurance underwriter which permitted its products to be sold by unlicensed individuals.

Third, piecemeal action on the structure of the financial services industry should be avoided. What is needed is comprehensive reform; otherwise unintended and highly negative results are likely. While the Congress has recently tried and failed to pass comprehensive reform, there is growing recognition that such reform is needed. There are now indications that the Administration will soon turn its attention to such issues. Comptroller Ludwig has already made clear that it is his belief that banks should be authorized to engage in fee income activities, such as selling insurance, which pose no safety and soundness hazard and which can benefit their customers. It would be highly counterproductive for Congress to rush to close a non-existent "loophole," whose usefulness is still clouded by a host of legal and practical questions, without considering the issue in the context of comprehensive reform.

Finally, precipitous action to shut down the town of 5,000 authority now would be extremely disruptive and economically damaging not only to national banks and State banks, but to life insurance companies.

As you are aware, both the 2nd Circuit in the *ALTA* case and the 5th Circuit in the *VALIC* case held that the small town authority is the only insurance authority granted to national banks and that the Comptroller of the Currency may *not* authorize any other insurance activities as "incidental" banking powers. Further, the 5th Circuit rejected the OCC's finding that annuities were investment, not insurance products, and also went out of its way through dicta to try to create a conflict with the D.C. Circuit's decision regarding the geographic scope of the small town authority. It was still unclear whether the OCC will appeal the 5th Circuit decision, much less whether the Supreme Courts would grant certioraris.

ABA does not agree with the *ALTA* and *VALIC* holding. Nonetheless, what all this means is that there is a real danger that, if the small town approach is precipitously closed, national banks may lose the only legal authority for existing insurance sales and related activities—including the sale of credit insurance and the marketing of annuities. The many State banks which market these products under the "wild card" statutes which conform their activities to those of national banks would be similarly deprived.

In short, this Committee could be striking an extremely damaging economic blow to national banks, State banks, and to the life insurance industry which supplies these products. Worse yet, consumers used to buying affordable insurance from these banks will also feel the pain of losing an important source of insurance.

The stakes are quite large. There is about $300 billion worth of credit life insurance currently in force, a substantial amount of it marketed through banks. And bank marketing of annuities, while relatively new, has already grown to extremely significant proportions. About one quarter of all U.S. banks now market annuities. Their 1992 sales totaled $7.7 billion, generating an average net fee income of 3.7 percent or $285 million in the aggregate. If all banks marketed annuities, the industry's total potential net income would be about $700 million.

In 1992, banks sold more than one in every five annuities in the United States—25.7 percent of all fixed annuities and 10.1 percent of variable annuities. In short, if you close this small town approach and thereby deprive the banking industry of what may be its only legal authority for annuity sales, you will not only be depriving the banking industry of significant fee income, and our customers of a convenient and low-cost, low-commission distribution system, but you will also be depriving the life insurance industry of a major, growing outlet for its products.[1]

Finally, there is considerable evidence that bank sales of annuities have not been at the expense of traditional life insurance agents. To the contrary, all the data indicates that banks are not taking away a slice of the annuities pie but expanding the size of the pie.

This is consistent with other data that bank insurance sales have not decimated the ranks of traditional insurance agents. For example, a study prepared for the Virginia Bankers Association compared the number of insurance agencies and agents in North Carolina (where State-chartered banks have been permitted to sell insurance throughout the 1980's) with the corresponding number of insurance agencies and agents in Virginia (where bank insurance activities are not permitted). The results showed no evidence that permitting banks to sell insurance results in fewer insurance agents, agencies, and premiums written.

Surveys of banks active in marketing annuities indicate that 60 percent to 80 percent of their customers are first-time buyers who are not the object of marketing by traditional life insurance agents. They are generally middle-market, less affluent customers who are not reached by traditional agent marketing methods. They are introduced to annuities by bank employees who have reviewed their financial and investment needs and have demonstrated to them that their goals can best be reached by a mixture of traditional bank-savings products with other investments, such as annuities and mutual funds.

## IV. Conclusion

Mr. Chairman, the ABA believes it is time for Congress to adjust existing Federal banking law to more closely reflect the realities of today's evolving competitive market place. On the issue of interstate banking and branching, we support the basic approach contained in the legislation passed by the Senate in 1991. This approach would ensure that a uniform, orderly system of interstate banking and branching would be put in place, while retaining appropriate authority for the States.

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[1] Data regarding bank annuity sales provided by Kenneth Kehrer Associates of Princeton, NJ.

The ABA will strongly oppose legislation imposing further restrictions on banks' ability to sell insurance products. Such restrictions would deprive thousands of bank customers of a convenient, low cost source of insurance vehicles. As my testimony describes, the cross-marketing of credit and insurance is going on daily in financial markets. If banks, both large and small, are to be able to compete against non-bank firms such as Primerica/Travelers, then this Committee must reject the urgings of those who would deprive us—and our customers—of the ability to offer a full spectrum of financial products and services.

I look forward to working with you, Mr. Chairman, and the Members of this Committee, on these important issues. I would be happy to answer any questions you may have.

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## PREPARED TESTIMONY OF JAMES R. LAUFFER

Mr. Chairman, I am James R. Lauffer, Chairman/President/CEO of the First National Bank of Herminie in Irwin, Pennsylvania. I am also President of the Independent Bankers Association of America, which is the only national trade association that exclusively represents the interests of community banks.

We appreciate this opportunity to testify on proposals that would mandate interstate banking and branching and restrict the sale of insurance by national banks in towns of less than 5,000 while concurrently placing a large regulatory paperwork burden on national banks that sell insurance.

### Interstate Banking and Branching

We believe that the States are doing a fine job addressing the interstate banking and branching needs of their States and we oppose Federal preemption. Frankly, State governors and legislatures are in the best position to make this call, which goes to the heart of the financial and economic development of their States. There will be State winners and losers in any Federal preemption bill. The winners will be those few States where multistate or multinational banks have their headquarters. The losers will be those States that lose control over their banks, jobs and branch offices as the result of federally mandated consolidation. We have all heard about the hundreds of millions that will be saved by consolidation. Think about it—how many jobs will be lost—how many branches would be closed to effect such savings?

We also have to be concerned about the fairness of the resulting end product. Over time, mandated interstate banking and branching would result in *unfair* competition, increased financial concentration, harm to consumers, decreased credit available to entrepreneurs, and less local control over the financial system.

Federally mandated interstate banking and branching will harm the banking system and consumers. The first effect will be one of unfair competition. Consumers will be harmed by the imposition of higher fees as competition lessens. Credit availability will lessen as the interstate banks restrict credit offerings to a narrow laundry list of generic loans with high minimum borrowing requirements. Finally, there will be a loss of local control over banks that will erode a sensitivity towards local community credit needs.

*Unfair Competition*

The large banking institutions that are seeking interstate branching legislation have an unfair competitive edge over community banks—they are too-big-to-fail. Regulators will do whatever is necessary to prevent them from failing and see that no depositor or creditor, insured or uninsured, will lose money. In recent history, we have seen the too-big-to-fail doctrine used to rescue First Pennsylvania Bank in 1980, Continental Illinois National Bank in 1984 and various Texas banks, through the failure of Bank of New England in 1991.

In response, the FDIC Improvement Act of 1991 codified the too-big-to-fail doctrine in the "systemic risk" provision while increasing the risk to uninsured depositors in community banks. The "prompt corrective action" and "least cost" requirements have ended the FDIC's former failure resolution techniques that tended to protect all depositors in failed banks. Now, in virtually every community bank failure uninsured depositors take a hit. In 1992 depositors in failed banks had over $323 million in 17,354 accounts that exceeded the insured level. The FDIC made only partial payment on these funds. (See attachment.)

The too-big-to-fail doctrine continues to exist for the largest banks and operate to the competitive disadvantage of community banks. A recent *Washington Post* article revealed that regulators worked for several years to keep Citicorp afloat. (Article at-

tached.) And, even if that effort had proved unsuccessful, the regulators could have invoked the "systemic risk" provision to keep the bank open. In contrast, the regulators would not work to keep a small, community bank afloat.

Press coverage of the too-big-to-fail policy has led some customers to move funds out of small banks. Mandated interstate banking and branching would clearly make this situation worse.

Larger banks also have an advantage in dealing with the ever-increasing regulatory burden. They are able to devote specialists to regulatory compliance while smaller-bank staffers must wear many hats. For example, NationsBank Community Investment Executive Catherine Bessant recently told a Housing Roundtable that NationsBank employs 110 people to do its CRA work. Last year, the IBAA/Grant Thornton survey found that 80 percent of the responding community banks (over 2,000) had less than 49 *total* full-time employees. Banks the size of NationsBank can afford to hire hundreds of people to focus on regulatory compliance. Community banks cannot. In addition, large banks are examined for CRA on a bank-wide basis and not on an office-by-office basis as are small banks. This further increases the differences in regulatory burden between large and small banks. Finally, non-bank financial firms simply have a lighter burden than anyone in the banking industry, adding to the regulatory unfairness.

We are asking you to recognize that FDICIA went too far in an understandable reaction to the savings and loan taxpayer bailout. When FDICIA was enacted, the underlying premise was that a further bailout of the FDIC's Bank Insurance Fund would be needed. This premise, as promoted by the General Accounting Office, has proven to be substantially inaccurate.

My banking colleagues are telling me that they must, and in my bank I must, give first priority to serving the demands of government agencies, taking precious time away from customer service and business development. We urge this committee to act quickly to lift this regulatory burden, especially for smaller banks that are facing stiff competition from large competitors. We must do this to maintain the current wide range of choices that consumers and businesses now have.

*Financial Concentration*

Even without mandatory interstate banking and branching much of business and consumer choice in financial services has been eroding because financial concentration has surged. The *American Banker* just reported that the assets held by the Nation's 100 largest banking companies jumped by 5.0 percent in the first six months of this year, while the rest of the industry shrank. As a result, the share of assets for the top 100 surged by two full percentage points, to 73.0 percent, the survey found. Mergers were the cause of half of the asset increase. (September 30, 1993.)

We can also measure increasing concentration by comparing the number of institutions under $100 million in assets with those over $10 billion. The number of small institutions has declined 31 percent since 1984, while the number of large institutions has increased by 75 percent (from 32 to 56). The large banks have also increased their share of assets, while smaller banks' share has declined. (Chart attached.)

This consolidation, especially when driven by mergers, leads directly to layoffs. What public policy is served by pushing legislation that accelerates such trends? In today's economy we need more, not fewer jobs in every sector.

Supporters of increased concentration assert that concentration stems from market forces that government should allow to take their course. A study by two economists at the Federal Reserve Bank of Minneapolis came to a much different conclusion. They believe that regulatory policies, such as too-big-to-fail, the difficulty of mounting hostile takeovers of large banks, and regulatory encouragement of mergers, not market forces, explain the consolidation trend. (Boyd & Graham, Investigating the Banking Consolidation Trend, Federal Reserve Bank of Minneapolis, *Quarterly Review*, Spring 1991.)

Are the consolidated banks somehow safer than smaller institutions? No. "The empirical evidence shows that, contrary to popular belief, in recent years, larger banks have gotten into trouble more often than smaller banks." (Boyd & Graham, p. 11.)

These findings were echoed in a study done by Arthur E. Wilmarth, Jr. Associate Professor of Law, George Washington University, National Law Center. (Wilmarth, Too Big To Fail, Too Few To Serve? The Potential Risks of Nationwide Banks, *Iowa Law Review*, March, 1992.) Professor Wilmarth found that geographic diversification can be dangerous for banks, as shown by the near failure of SeaFirst National Bank and Continental Illinois National Bank due to their purchase of energy loans from geographically distant areas of the country. The Bank of New England's failure was

also due in part to real estate loans made outside of New England, especially those made in Florida.

Large banks have been less profitable than small banks according to Wilmarth. When banks have entered new areas through consolidation they have done a poor job of determining the new community's banking needs, and they have generally been unable to create the economies of scale that were claimed to exist at the time the combination was announced.

Generally, the biggest and most consistent cost savings comes at the expense of higher unemployment because entire branches and their staffs, back room personnel and senior managers are eliminated. On December 11, 1992, Bauer Financial Reports, Inc. reported that employment in banks, thrifts and credit unions was reduced by 56,595 employees between June, 1991 and June, 1992. Bauer Financial Reports concluded that the job loss was caused by the consolidation of the industry. Bank of America reported on March 19, 1992 that it would eliminate between 10,000 and 12,000 jobs as a result of its merger with Security Pacific Corporation. The list goes on and on.

We urge Congress to reject proposals like mandated interstate banking and branching, since those would lead to even faster increases in financial concentration and more risk to the system. Increasing concentration also decreases competition in the financial marketplace, despite claims that unfettered branching increases competition. It will not, and it will hurt consumer and small businesses.

*Harm to Consumers and to Main Street*

The same multistate an/or multinational banking corporations, with the possible exception of NationsBank, that are pushing for federally mandated consolidation rights and interstate branching privileges are simultaneously pushing for preferential CRA treatment. They do not want CRA applied to their local branches—but rather to their Statewide or national operations. This would allow them to use their Main Street America branches to secure core deposits trading on their too-big-to-fail status. It would lift the CRA burden on those banks who are best equipped to bear it while keeping the CRA burden on local banks whose only market is the local community. Again, we ask—what public policy purpose would this serve?

There are other concerns. A 1990 study by the American Association of Retired Persons found that:

> . . . Deregulation of deposit account interest rates has not resulted in higher returns for everyone. Large banks where the majority of consumers deposit their money are often paying lower interest and charging higher fees for their service than smaller banks . . . as deregulation continues, the market share of large banks is expected to continue to increase. The result would be less competition and still higher prices.

California, which has permitted Statewide branching for decades, is often cited as a model for unlimited interstate branching. While it is true that many community banks continue to operate in that State, the market is highly concentrated—4 banks controlled over 60 percent of the deposits in 1991. Writing in the Iowa Law Review of March, 1992, Professor Arthur E. Wilmarth, Jr. noted that California consumers pay a high price for this concentrated market:

> California banks have paid interest rates on transaction accounts that are significantly lower than both the national average and the average rates paid in out-of-State metropolitan markets, and California banks have charged interest rates on loans that are significantly higher than both the national average and the average rates paid in out-of-State urban areas. These facts indicate that California's liberal laws on bank structure have permitted a few very large banks to dominate the State's banking markets, and that California's markets have been substantially less competitive than comparable out-of-State markets. (p. 1145.)

Professor Wilmarth also cited studies comparing checking account costs and availability between the U.S. and Britain. Significantly fewer consumers have checking accounts in Britain than in the U.S. "due to the high service charges assessed by British banks on those accounts." (p. 1053.)

And we have our own case study. It is in the credit card arena where Senator D'Amato has taken the lead on focusing on high credit card rates and the past uniformity of rates that suggested cartel-like behavior. The 1,401 community banks in IBAA's Bancard program continue to charge annual interest rates and annual fees that are much lower than those charged by large national issuers. Over 1.5 million cardholders enjoy these favorable terms.

The average community bank rate is 14.72 percent for standard cards, while the national issuers charge 17.76 percent. The average community bank annual fee for

standard cards is $15.38, while large national issuers charge nearly $17.00. These are averages; many community banks offer even better terms.

This bears out the findings that Professor Nicholas M. Didow presented to a Congressional subcommittee several years ago: "The larger the bank, the higher the level of fees. The smaller the bank, the lower the level of fees."

*Less Credit Available*

Consumers are not the only losers in a concentrated financial market. Larger banks simply do not find it economical to make small business and consumer loans. Richard L. Thomas of First Chicago Corp. told the House Government Operations Committee earlier this year that:

> In one of the really large banks in the country today, it would be difficult to make money on a loan of less than half a million dollars. I suspect the number might be $25,000 for a much smaller bank with a much smaller overhead. . . .

Few start-up businesses can qualify for, or need, a loan of $500,000. As the Nation's banking system becomes increasingly dominated by "the really large banks" where will those smaller borrowers turn for credit? They could face a permanent credit crunch. As we have learned over the last few years, less credit for small business means slower job creation.

The experience in Canada and Britain is not reassuring. Professor Wilmarth found that:

> [T]he decentralized U.S. banking system is more competitive and responsive than the highly concentrated British and Canadian systems in providing credit to small businesses. The apparent reason for the superior performance of U.S. banks is that most British and Canadian small businesses are served by large nationwide banks, while small firms in the United States are served primarily by local independent banks. (p. 1055)

Some claim that a secondary market could help serve small businesses. We doubt it. A secondary market would have to impose strict uniformity on qualifying loans. The small business loans that community banks make today do not fit "cookie cutter" standards. They are tailored to individual circumstances that Wall Street investors in secondary markets simply could not accommodate.

Large banks are unable to meet the needs of low- and moderate-income customers, especially in rural America. Most community banks still make small, unsecured consumer loans. One of IBAA's members from North Dakota recently told me that his bank has made over 150 consumer loans ranging from $100 to $1,000 since the first of the year. This is in addition to several housing loans of under $5,000. Just try and borrow $100 from any large bank today and see the response that you get!

*Less Local Control*

Mandatory interstate banking and branching, by definition, decreases local control over banking resources. It transfers economic control to far away headquarters and it transfers political control from State and local officials to Federal agencies.

For example, in December of 1991, the entire Board of Directors of the NCNB (now NationsBank) bank in Victoria, Texas, resigned to protest the firing of the bank's two top officers. The two officers were fired by NCNB's corporate district office in Houston suddenly, with no prior warning and no explanation to the Board.

Resigning Board Chairman Bill Noble had this to say about the bank's relationship with its out-of-State parent company. He said, "My main concern is what's happening to Texas banking. Ownership is being controlled by out-of-State banks."

Mr. Noble said there was a lack of commitment to the community by the North Carolina-based bank, with a paltry loan-to-deposit ratio of only 17.5 percent. "Go out and try to get a loan," he said. "It's almost impossible."

Mr. Noble also charged that NCNB showed a callous disregard and disrespect for its Texas employees. When NCNB first took over the Texas bank, the bank had 136 employees. Today, the bank has 28 employees, and the branch has a year-end mandate to cut back to 24½ full-time employee equivalents.

"It is management by intimidation," he said, adding that employees are afraid to stray from corporate policy for fear of losing their jobs.

Most interstate banking and branching proposals purport to give States the ability to "opt-out" of the Federal mandates within a fixed time frame. This puts a heavy burden on opponents of interstate operations, since they have a limited opt-out window. Supporters of interstate branching could simply dig in their heels for a brief period and the game would be over.

If Congress must pass anything it should adopt the model provided in the Douglas amendment to the Bank Holding Company Act. Douglas permits the States to "opt

in" to interstate bank ownership. Since 1984, most States have taken action to allow interstate banking, either on a regional or on a national basis, and many are still adjusting to the consequences of their decision. Similarly, it should be left to the States to decide whether they wish to permit out of State banks to branch freely into their States rather than forcing it down their throats. States need a determining role in this process, since they will find it increasingly difficult to regulate or tax branches of nationwide or worldwide banking companies. And the Congress would be well advised to consider the taxpayer implications of that tried and true saying—the bigger they are, the harder they fall.

*Recent Studies*

Since the Congress last considered interstate banking and branching a number of independent studies were released which seriously undermine the arguments for these proposals. This is what they said:

- [F]ull-scale nationwide consolidation could impair the safety, efficiency and profitability of the banking industry. Consolidation could also reduce competition among banks and restrict the availability of credit to smaller businesses and local communities. (Wilmarth, Too Big To Fail, Too Few to Serve? The Potential Risks of Nationwide Banks, *Iowa Law Review,* March 1992, p. 960.)
- Over the next decade or so, it is reasonable to expect that a few banks will be far larger than any that the regulators have had to supervise so far, and there will probably be a considerable number of what are considered very big banks by today's standards. Because of their sheer size and the nationwide scope of their community banking operations, it may be a challenge for the regulators to adequately supervise such banks. In addition, the regulators will be faced with a considerably larger number of banks that may be regarded as too big to be allowed to fail because of concern with broader effects that such failures may have on the stability of other banks and the financial system more generally. (Timothy H. Hannan & Stephen A. Rhoades, Future U.S. Banking Structure: 1990 to 2010, Federal Reserve, Washington, DC, 1992, pp. 69–70.)
- Many proponents of nationwide banking argue that interstate branch banking would be more cost effective than multistate bank holding companies because the costs associated with operating multiple banks would be eliminated. . . . In general, the data do not confirm the hypothesis that the operating costs of branch banking systems are lower than those of multibank holding companies. (Stephen A. Rhoades & Donald T. Savage, The Relative Operating Costs of Multibank Holding Companies and Branch Banks, Federal Reserve, Washington, DC, 1992, p. 1.)
- This paper examines the non-interest expenses of bank merger partners for the two years prior to the merger and the four years after the merger. Our sample consists of all bank mergers between 1982 and 1986 in which each of the participants had total assets of at least $100 million. . . . *We have not found any evidence that mergers significantly lower expenses.* (Emphasis added.) (Aruna Srinivasan & Larry D. Wall, Cost Savings Associated with Bank Mergers, Working Paper 92–2, Federal Reserve Bank of Atlanta, February 1992.)

## Insurance Powers

You have asked for our comments on a proposal that would limit the exercise of the sale of insurance by a national bank with an office in a town of less than 5,000 people. The proposal would limit sales to the town and a small geographic area surrounding the town, with a grandfather provision for existing customers. The proposal would require a bank to create extensive paperwork to document to the regulators that its exercise of insurance powers is within the statutory limits.

We strongly support providing banks the authority to offer retail financial products, including insurance products, to their customers. We particularly support providing banks the authority to sell annuities and will continue to strongly oppose any attempts by the insurance industry to restrict community banks' annuity sales.

We very much welcomed the Supreme Court's ruling that banks in towns of 5,000 or fewer continue to have special authority to provide insurance to all of the communities that they currently serve. This authority should be extended to insurance sales within the entire State. We do not believe that national banks located in these small towns should be able to sell insurance without geographic limit. There should, however, be a grandfather provision to protect those already engaged in such interstate activity. In our view this issue is closely tied to nationally mandated interstate branching which the IBAA strongly opposes.

In your request to testify, you asked us to comment on Section 704 of S.543, which was passed by the Senate on November 23, 1991. In addition to restricting the exercise of insurance powers by national banks with offices in towns of less than

5,000, it would place a regulatory paperwork burden on banks that would be so heavy as to virtually force a bank to stop selling insurance to many of its customers. Generally, the bill would allow banks to sell insurance in their towns, and in a contiguous rural area within 7.5 miles of the town. First, towns do not have regular boundaries, and determining where the line 7.5 miles from the existing border runs would probably require the services of a surveyor. This would be an expensive proposition. Second, determining whether a person is a resident of the area could be difficult. For example, where the line goes through a farm, can homeowners and life insurance for the farmer be sold if the house is on the portion of the property outside of the line? Can the bank sell business related insurance to the farmer on the entire property, or only the portion within the line?

Third, the bill would grandfather certain existing insurance customers of the bank if they did not meet the location requirements. For example, if a bank has, "without interruption," provided insurance to the customer, it can continue to do so. Maintaining, in perpetuity, records to support the grandfather would be a huge burden.

The foregoing are only a few of the additional burdens that would be placed on national banks that wished to sell insurance for an office in a town of less than 5,000. At a time when it is clear that regulatory burden is having the effect of inhibiting banks from providing needed banking services, it is extremely counterproductive to put these additional burdens on banks. We believe our solution avoids these problems while providing consumers a useful service.

## Conclusion

We are here today to express our concern about and opposition to nationally mandated interstate banking and branching. We agree, and believe that with nationally mandated interstate banking and branching we would see unfair competition, increased concentration, higher costs to consumers, less credit for small business, and less local control. We also believe that to mandate interstate banking and branching at a Federal level will do grave damage to Federalism, State's rights and the dual banking system. We urge you to reject mandatory interstate banking and branching legislation.

Restricting the insurance powers of national banks with offices in towns of less than 5,000 to their town and strictly delineated surrounding areas would have severe negative repercussions for many small communities and their banks. The only purpose served by such an action is to decrease competition for insurance agents. It would cut back on income necessary for the health of many banks and severely restrict the convenient availability of insurance products for many residents of our small communities. We also urge you to reject these counterproductive restrictions on the exercise of insurance powers.

Failed Banks 1992

1/3/92
Assured Thrift & Loan Association
San Juan Capistrano, CA
$1,048,000 in 28 accounts exceeded insurance level

1/10/92
The Citizens Bank
Dallas, GA
$865,000 in 46 accounts exceeded insurance level

2/6/92
Landmark Bank of Fort Worth
Fort Worth, TX
$429,000 in 21 accounts exceeded insurance level

2/7/92
Merchant National Bank
Fort Myers, FL
$1 9 million in 61 accounts exceeded insurance level

2/21/92
National City Bank
Coral Springs, FL
$2.2 million in 20 accounts exceeded insurance level

2/21/92
The Bank of Brandywine Valley
West Chester, PA
$937,000 in 91 accounts exceeded insurance level

2/27/92
Columbia Bank
Avondale, AZ
$35,000 in 14 accounts exceeded insurance level

2/28/92
Mission Viejo National Bank
Mission Viejo, CA
$4.5 million in 130 accounts exceeded insurance level

3/6/92
New Heritage Bank
Lawrence, MA
$1 2 million in 47 accounts exceeded insurance level
advance payment: 0%

3/13/92
Broadway Bank & Trust Co.
Paterson, NJ
$6.3 million in 255 accounts exceeded insurance level

3/19/92
Independence Bank
Plano, TX
$435,000 in 27 accounts exceeded insurance level
advance payment: 67%

3/31/92
First Community Bank of Cherokee
Woodstock, GA
$953,000 in 44 accounts exceeded insurance level
advance payment: 59%

4/3/92
Bank of Beverly Hills
Beverly Hills, CA
$12.2 million in 200 accounts exceeded insurance le

4/3/92
Summit National Bank
Torrington, CT
$535,000 in 40 accounts exceeded insurance level

4/24/92
Valley Commercial Bank
Stockton, CA
$777,000 in 44 accounts exceeded insurance level

4/24/92
Shore Bank & Trust Co.
Lynn, MA
$4 million in 128 accounts exceeded insurance level
advance payment: 59%

5/1/92
Metropolitan Bank, N.A.
Washington, D.C.
$1 3 million in 33 accounts exceeded insurance level
advance payment: 55%

5/4/92
The Financial Center Bank, N.A.
San Francisco, CA
$1.7 million in 184 accounts exceeded insurance leve
advance payment: 45%

5/7/92
Jackson Exchange Bank & Trust Co
Jackson, MO
$1.1 million in 27 accounts exceeded insurance level

5/7/92
First Exchange Bank of Cape Girardeau
Cape Girardeau, MO
$942,000 in 38 accounts exceeded insurance level

5/7 92
First Exchange Bank of St Louis
St. Louis, MO
$35,000 in 4 accounts exceeded insurance level

5/7/92
First Exchange Bank of North St Louis
North St. Louis, MO
$15,000 in 4 accounts exceeded insurance level

5/7/92
First Exchange Bank of Madison County
Fredericktown, MO
$31,000 in 9 accounts exceeded insurance level

5/8/92
Brookfield Bank
Brookfield, CT
$823,000 in 62 accounts exceeded insurance level

5/15/92
Malden Trust Co.
Malden, MA
$1.6 million in 54 accounts exceeded insurance level
advance payment: 75%

6/12/92
American Interstate Bank
Newport Beach, CA
$1.4 million in 34 accounts exceeded insurance level
advance payment: 75%

6/25/92
Castle Hills National Bank
San Antonio, TX
$106,000 in 11 accounts exceeded insurance level
advance payment: 87%

6/25/92
American National Bank-Post Oak
Houston, TX
$1.3 million in 33 accounts exceeded insurance level
advance payment: 78%

6/26/92
Olympic International Bank & Trust
Boston, MA
$618,000 in 33 accounts exceeded insurance level
advance payment: 75%

6/26/92
Vernon Bank
Vernon, CT
$77,000 in 10 accounts exceeded insurance level
advance payment: 23%

6/30/92
American Savings Bank & Riverhead Savings Bank
White Plains, NY
$119 million in 8,600 accounts exceeded insurance le
advance payment: 75%

7/23/92
First National Bank of Texas
Webster, TX
$1 2 million in 120 accounts exceeded insurance level
advance payment: 75%

7/31/92
Massachusetts Bank & Trust Co.
Boston, MA
$1 5 million 29 accounts exceeded insurance level
advance payment: 0%

8/28/92
Seacoast Savings Bank
Dover, NH
advance payment: 84%

8/28/92
The Union Savings Bank
Patchogue, NY
$14.1 million in 428 accounts exceeded insurance level
advance payment: 80%

9/10/92
The First National Bank of Yorktown
Yorktown, TX
$360,000 in 32 accounts exceeded insurance level
advance payment: 31%

9/18/92
The Washington Bank
Fairfax County, VA
$2 2 million in 35 accounts exceeded insurance level
advance payment: 64%

10/16/92
Universal Bank
Lanham, MD
$330,440 in 27 accounts exceeded insurance level

11/1/92
First New York Bank for Business
NYC
$7 9 million in 550 accounts exceeded insurance level
advance payment: 50%

11/13/92
Guaranty-First Trust Co.
Waltham, MA
$3.8 million in 270 accounts exceeded insurance level
advance payment: 66%

11/13/92
Metro North State Bank
Kansas City, MO
$5 million in 660 accounts exceeded insurance level
advance payment: 50%

11/20/92
Metro North Bank
Kansas City, MO
$2.5 million in 600 accounts exceeded insurance level

11/20/92
The Merchants Bank
Kansas City, MO
$100 million in 2,900 accounts exceeded insurance level
advance payment: 50%

12/4/92
Burritt Interfinancial Bancorp.
New Britain, CT
$10 million in 800 accounts exceeded insurance level
advance payment: 72%

12/11/92
Eastland Bank & Eastland Savings Bank
Woonsocket, RI
$5.4 million in 540 accounts exceeded insurance level
advance payment: 71%

12/14/92
Huntington Pacific Thrift & Loan Assoc.
Huntington Beach, CA
$148,000 in 56 accounts exceeded insurance level
advance payment: 76%

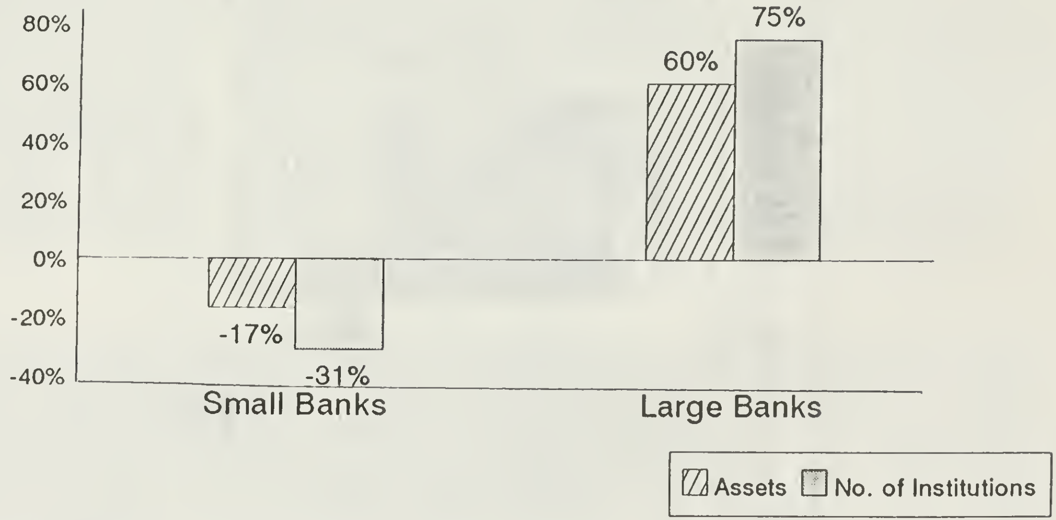
12/18/92
The Rushville National Bank
Rushville, IN
$489,000 in 35 accounts exceeded insurance level
advance payment: 54%

**49 = total number of failures where depositors lost money**
**$323,288,400 in 17,354 accounts exceeded insurance level ****

** excluding NH bank (info not available)

PERCENT CHANGE IN ASSETS AND NUMBER OF INSTITUTIONS

1984-1992




Note shift in number and assets to larger banks.

# The Saving of Citibank

*Partnership of Regulators, CEO Brings Firm Through Crisis*

By Brett D. Fromson
and Jerry Knight
Washington Post Staff Writers

On the Wednesday before Thanksgiving 1990, Citicorp chief executive officer John S. Reed walked through the main doors of the fortress-like Federal Reserve Bank of New York, on his way to a meeting that would mark the beginning of an effort to save the nation's largest bank from financial disaster.

The Citicorp chief executive had been summoned by two of the most powerful regulators in the federal government: E. Gerald Corrigan, president of the New York Fed, and William Taylor, director of the Fed's division of bank supervision in Washington. In Corrigan's wood-paneled conference room on the 10th floor, the regulators got directly to the point. Sources familiar with the meeting recall the regulators' polite but blunt message this way:

Citicorp CEO John S. Reed drafted the plan to strengthen Citibank.

The U.S. banking system was headed for trouble and so was Citibank, the regulators warned, because of the sharp decline in the real estate market. With its vast deposits, Citibank had a unique responsibility to strengthen itself to help maintain public confidence in the banking system, they said. Loss of confidence could trigger a run on Citibank that would not only threaten the bank, but the entire financial system.

Citibank must do whatever it took to restore its strength, Corrigan and Taylor stressed, even if that meant selling prized businesses, cutting dividends to its shareholders or watering down shareholders' investment by selling more stock.

The meeting was a wake-up call for Reed, who until then had believed that Citibank could get through the real estate crunch without major damage. And it began an extraordinary 2½-year partnership between Reed and the regulators to rescue the nation's biggest bank and avoid worldwide financial turmoil.

The Citicorp saga provides a case study of how financial regulation works in a crisis—subtly, se-

See CITIBANK, A20, Col. 1

cretly and, in this case, successfully—to nudge a giant bank back from the brink.

The rescue mission that began that day in November 1990 is now coming to an end, according to regulators and Citicorp officials alike. The huge bank, with its $213 billion in assets, remains on the government's "problem bank" list, say Citicorp and Washington sources, but its survival no longer seems to be in doubt. Nor is that of its chairman, who has dodged the bullet that struck the chief executives of so many of the nation's other corporate giants, such as International Business Machines Corp., General Motors Corp. and American Express Co.

One sign that Citibank's crisis has passed is that Reed is no longer required to attend monthly meetings with regulators in Washington to monitor the bank's progress. Those mandatory updates ended earlier this year, banking sources say.

And on Wall Street, where confidence is measured by the price of a stock, Citibank shares have rebounded from a low of $8.50 a share in December 1991 to as high as $30 this year, a resounding comeback.

The stakes for the regulators in this case were enormous. "We were running fire drills in case they had a problem that required government attention," one top former official recalled. A run on Citibank would have required intervention by the Federal Reserve and help from the central banks of other nations, another key insider said.

What evolved was a kind of co-management of the bank. For the last 2½ years, every significant corporate decision made by Reed has been cleared in advance by officials of the Federal Reserve Board, which regulates the bank's holding company, Citicorp, and by the Office of the Comptroller of the Currency (OCC), which oversees its major subsidiary, Citibank NA.

The Citicorp story is also a study in executive survival tactics. Reed was in charge when Citibank made the risky real estate loans that got it in trouble and could well have lost his job as a result.

But after being roused by the Fed officials, Reed seized the initiative—and stayed one step ahead of the regulators and his own board of directors. He kept the confidence of both constituencies and saved not only the bank and his hefty salary and bonus (which totaled $2.2 million last year) but also his reputation.

Confident that the crisis is past, some of the people involved in saving Citibank are now beginning to talk. This account is based on interviews with current and former regulators, and with executives and directors of Citicorp who participated in the events described or worked closely with those who did.

Few of the sources would allow their names to be used. Of the two key Fed players, Taylor died unexpectedly last summer and Corrigan has refused to discuss regulatory issues.

## In the Path of a Real Estate Disaster

When Taylor and Corrigan summoned Reed and Citicorp President Richard S. Braddock to the crucial pre-Thanksgiving meeting at the New York Fed, they were worried, colleagues say. The regulators felt they needed to warn Reed that Citibank was standing in the path of a wave of commercial real estate disasters that already had wiped out nine of the 10 largest banks in Texas and was now rolling toward the Northeast.

Citibank was unprepared, the regulators feared. Though its real estate losses had doubled in the previous year, they were still tiny, and only six months earlier the bank has assured shareholders the losses would be no more than 1 percent of the loans.

Taylor and Robert L. Clarke, then comptroller of the currency, knew that throughout the banking industry, real estate losses were running [illegible]—even worse at some banks—and that Citibank had more real estate loans than any other bank in America. Citibank's commercial real estate portfolio totaled roughly $30 billion, by one 1990 internal Citicorp estimate.

The regulators were convinced that Citicorp would need more capital to weather this storm. Corrigan and Taylor advised Reed that with its huge global real estate portfolio, Citi would need to raise as much as $5 billion in new capital to cover the likely losses.

Until that moment, Citicorp had not given serious consideration to such a large increase in capital, company officials acknowledge.

According to sources familiar with the meeting, Reed listened as Taylor ticked off his prescription: Stop the dividend, sell more stock, unload assets to raise cash—all actions likely to drive down the price of Citicorp shares.

Taylor and Corrigan did not order Reed to do anything that day, setting a pattern for the relationship between the government and the bank that continued through the subsequent 2½ years of partnership. But they reminded him that the bank's future was at stake. Obviously, Reed's job was also at stake.

"The message was not delivered toughly, but as things subsequently unfolded, it turned out to be a very tough message indeed," a Citibank official recalled.

Reed was chastened by what he had been told, according to former top Citi executives.

"I remember talking with him later that day," said one. "He spoke about the meeting as a lesson. This should be a lesson to never manage your bank in such a way so that the regulators can come back and start telling you either how they think it should be managed, or how it will be managed if you don't do certain things."

## Ignoring Signs of Trouble

When Taylor and Corrigan sounded their alarm bell, Citicorp was only beginning to recognize its problems. Its profits would fall sharply in 1990, to $458 million from $1.86 billion only two years earlier. But insiders say no one at the bank anticipated that 1991 would produce the bank's first losing year since the Depression—a $457 million loss.

The problem was not only bad loans and the reserves that had to be set aside to cover them, but escalating expenses. The bank was also finding it increasingly difficult to borrow short-term money at reasonable interest rates. Some Wall Street analysts were muttering darkly about an incipient slow-motion run on the bank.

Citibank was insulated from recognizing these problems by its own size and history. Descended from the famously conservative First National Bank of the City of New York that was chartered in 1863, Citicorp had become a global giant with 3,300 offices, operating on every continent except Antarctica. It claimed to do business with one in every four households in the United States.

Reed and the other senior managers who had mappe the strategy that took Citibank so deep into real esta were slow to recognize they had blundered into a m disaster. "No question, there was a period of deep d it," recalled one former executive. "We did not fee we had to deal urgently with the problem."

Largely uninformed of the details of Citi's real activities, Reed asked for a briefing on the issue 1990. The assurances he received left him c that Citi was still on solid ground, and Citico tives expressed the same confidence at a Febr board meeting

Said one former director who attended th remember with great clarity. Holy macke were they denying a problem, they were about real estate. Prior to the period of

period or misleading. . . My only explanation of why John allowed it was that he was not as close to the situation as he might have been."

At this time, regulatory scrutiny was less than aggressive at the bank, according to former senior executives. "The regulators were tolerated, but that was about all," said one former top credit officer. "They had no real muscle, no major say."

After the Thanksgiving meeting, Reed finally took decisive action. He announced in January 1991 that the common stock dividend would be cut nearly in half, from 44.5 cents per quarter to 25 cents, so that a greater portion of the bank's profits could be retained to build up its capital.

Cutting the dividend was a difficult decision, not only for Reed but for the regulators, who were sharply divided over how hard to push Citicorp on the issue.

At the time of the Thanksgiving showdown, L. William Seidman, then chairman of the Federal Deposit Insurance Corp., was complaining loudly about banks that were continuing to pay dividends when they were clearly in financial trouble. Clarke at the OCC, meanwhile, feared that cutting the dividend would make it impossible for Citicorp to raise new capital. And for Corrigan at the Fed, the overriding concern was to avoid any sudden shocks to the financial system, a Federal Reserve source said. Dropping the payout would be an admission that the bank was in much worse shape than anybody had known.

The compromise—which regulators knew would bring criticism that they were not moving fast enough—allowed Citicorp to reduce the dividend first to give the market time to adjust and then, later, to eliminate it entirely. By late 1991, the dividend had been suspended.

Along with the dividend cut, Reed drafted what he called "The Plan." It was a five-point statement of what the bank would do in 1991-92 to strengthen itself—a direct response to pressure from Washington.

To unveil The Plan, in January 1991 Reed retreated with his 50 top executives to Great Gorge, a ski resort in northern New Jersey about 90 minutes from Manhattan.

First, Reed said that Citi's top management—famous as long-range visionaries—would focus their attention exclusively on the short-term problems of the next two years. Second, operating expenses would be slashed. Third, new stock would be issued and parts of the vast array of businesses within Citicorp would be sold. And while dealing with the problems, Citi would continue to build on the strength of its core businesses and to maintain strong customer relationships.

Top managers generally welcomed The Plan, but those lower down were leery. "Skepticism was a mile high, both in terms of Reed personally and his plan," said one former executive who was at Great Gorge. "The rank and file viewed it as more corporate bs."

Some Citicorp directors and senior executives were also dubious about Reed's moves. Board members began to get back-channel phone calls from former insiders, who wondered whether the board ought to consider replacing Reed.

At the urging of several directors, Reed added a special session on top management to the agenda for the March 1991 board meeting at the Camino Real luxury hotel in Mexico City.

It was to be "a moment of drama," said a director who was there. "The Citi gang is always buttoned-down, in control. This time they didn't have the buttons. We did." If Reed's job was ever on the line, it was in Mexico City.

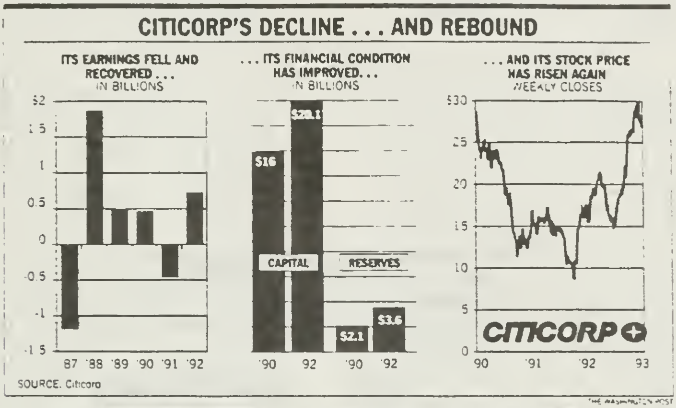
Reed handled the board superbly, by all accounts. He warned them of serious trouble ahead and presented a bold plan to deal with it. Neither defensive nor downhearted, he detailed his most up-to-date thoughts on how to execute The Plan.

He asked three questions of the directors. Had he analyzed the problem correctly? Did his solution make sense? And did Citi have the guts to carry it through to the end?

Each director spoke and, according to one, "The reactions ranged from 'Looks okay, John,' to more thoughtful versions of that. But it was all approval for the plan."

Then the discussion turned to top management. Reed's top lieutenants left the plush, high-ceilinged parlor. Led by director John W. Hanley, former chairman of Monsanto Co., a number of directors complained about the inadequacies of some of Citibank's senior lending executives. They also wondered aloud whether Reed had enough people close to him who knew how to deal with regulators.

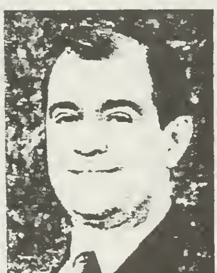
While names were not named, there was no doubt in most directors' minds that several top people must be replaced. "John had already reached the conclusion that people had to go," said one board member. "We were the straw that broke the camel's back."




BY RAY LUSTIG—THE WASHINGTON POST

E. Gerald Corrigan of New York Federal Reserve Bank met with Citibank's Reed.

WILLIAM TAYLOR
. . advised Reed to increase capital



JIMMY BARTON
. . . oversees Citibank for OCC

ROBERT L. CLARKE
. . . former comptroller of currency

## THE TOLL AT THE TOP

A photograph of these six executives ran inside the cover of Citicorp's 1989 annual report. The four executives in gray are gone, evidence of the shakeup at the company.

James D. Farley, vice chairman — Michael A. Callen, senior executive — Paul J. Collins, vice chairman

Lawrence M. Small, vice chairman — John S. Reed, chairman — Richard S. Braddock, vice president

THE WASHINGTON POST

WASHINGTON POST cont'd May 16-93

One reason the board stuck with Reed was that they saw no better alternative, inside or outside the bank. Another director explained. "I looked around the horizon. I saw nobody. I even got out the Business Council's roster [of CEOs]. I didn't find anybody I would trust more than John."

## Regulators Step Up Involvement

Citicorp's problems worsened along with the overall U.S. economy as 1991 wore on. "The bank deteriorated steadily, a continued erosion, and a growing involvement by the regulators," said a former top Citicorp executive.

Worried, the regulators became more aggressive. "They brought in tougher people, and there were more of them," recalls a senior bank officer who has since left. "It was a painful period that I am spending most of my time trying to forget."

Citibank was placed on the government's "watch list" of problem banks in December 1991. The list isn't made public, but every quarter the government reports how many banks are on it and totals their assets. The year-end report showed little change in the number of banks but a huge jump in the assets. Everyone in banking knew that Citibank had gone on the list.

As Citibank's problems worsened, a small army of regulators took up positions inside the bank. The OCC had its 22 regular examiners assigned to Citibank, with their own offices in one of the midtown Manhattan buildings that house Citicorp's operations. They had authority to see every record, every loan file, anything any time they wanted, explained Jimmy Barton, who oversees Citibank as deputy comptroller for multinationals.

The Federal Reserve had its examiners in the building every day, too, auditing the holding company. They were joined by special teams of expert examiners. At one point, there were as many as 300 banking examiners pouring over Citibank's books.

What regulators feared most, former government officials said, was a "funding crisis" like the one that took down Continental Illinois National Bank a decade ago. Much of Citi's funds are big corporate deposits, many from overseas that are not protected by federal deposit insurance. If those depositors got nervous and decided to withdraw their funds, even a healthy bank could not survive.

With so much at risk, it was in the interest of both the bank and its regulators to proceed without public confrontation.

"The [OCC] has believed for a long time that what we really like to do is to get management and the board to cooperate and fix their problems," Barton said. "If they are unwilling to do that, then we really don't have much choice but to use the more draconian powers that we have."

The OCC got draconian with Citibank in August 1992, issuing a "memorandum of understanding" (MOU) that put its demands in writing. Terms of the MOU remain secret, but as a publicly owned company, Citicorp was required to disclose that its relationship with the regulators had deteriorated to the point of written reprimand.

Citicorp officials insist the memorandum merely formalized its commitment to The Plan, but one regulator said the issuance of any MOU "means that we have not gotten the response that we would have suggested."

The question of whether to make Citicorp sign a MOU triggered intense regulatory debate, not only between agencies but within the ranks of the OCC and the Fed. Many top regulators were satisfied with The Plan. A written order would accomplish nothing, they argued. Reed was methodically moving to deliver what he had promised, taking his hits on real estate, rebuilding capital.

Reed still wasn't moving fast enough, the more hawkish regulators argued. Giving him so much time amounted to "forbearance"—regulatory jargon for bending the rules. "Forbearance" had become a nasty word in Congress and regulators feared that the lawmakers would come down on them if they did not come down on Citibank.

## Redoubling Cost-Cutting Efforts

Wall Street added more pressure, as investors drove the price of Citicorp stock below $9 a share in late 1991. Prodded by both the market and the regulators, Citicorp's redoubled its cost-cutting efforts. The bank also added more than $4 billion to its capital by selling stock and putting two dozen businesses on the block.

Some of the assets sold by Citicorp were odds and ends, offered at what amounted to a corporate garage sale. For example, the bank sold its stake in a Mexican company that brews Dos Equis beer.

But many of the assets that had to be sold were carefully nurtured corporate offspring whose sale represented a painful retreat from longtime Citicorp strategies. Promising high-tech ventures had to be abandoned. A huge student loan business went up for sale. And the regulators insisted that Citi sell two bond businesses that they viewed as costly risks to the bank.

As the cutting continued and regulators tightened their screws, more than 11,000 Citicorp employees lost their jobs. Antagonism between regulators and Citibank executives increased even as the bank's health began to recover.

Knowing that he would not be forgiven for failure, Reed kept pushing. He calmly fired dozens of top managers. But lopping off heads was only part of his plan. Reed decided that Citi needed a complete management shake-up so that he could more directly get a grip on the bank. He felt that he remained too insulated from the people he was relying on to cut costs and raise capital.

At a January 1992 retreat at a hotel in Connecticut, Reed announced that henceforth a group of the six top executives would rule, with a group of 15 lieutenants reporting directly to them. President Richard Braddock's authority was sharply reduced, and later that year, he left the company.

As part of the new order, Reed established task forces to solve specific logjams. "Everyone attacked the work very hard," said a former member of the group of 15. "They knew that their careers depended on the effectiveness of each task force. . . . It was intense and emotional."

The task forces found ways to cut almost $1 billion a year of non-interest expenses.

By late last year, the worst was over. The stock price began to recover, and courageous investors who had bought at the bottom began to cash out, doubling, even tripling their money.

Falling interest rates and the general rebound in the U.S. economy contributed to the turnaround, not only of Citibank but of the entire banking system.

This January, the regulators told Reed the monthly meetings were no longer necessary, even though the MOU technically will remain in effect until next February. Citicorp is continuing to set aside about $500 million each quarter to cover bad loans, but the corner appears to have been turned. Virtually every analyst on Wall Street has upgraded the stock.

Citicorp, however, is not the bank it was. Reed's prized overseas operations have been preserved but the bank's domestic sights have been lowered. An entire generation of top bankers has been lost.

Reed said in March that he will need until 1995 to get the bank fully revved up again, but some former Citicorp executives say that bank will not return to its past glory any time soon.

"It used to be *the* bank," said one. "Today, it is *a* bank."

## PREPARED STATEMENT OF CHRIS LEWIS

### Director of Banking and Housing Policy

### Consumer Federation of America

The Consumer Federation of America is pleased to be able to testify today before the Committee on Banking, Housing, and Urban Affairs on the matters of nationwide interstate branching and bank sale of insurance. Once again, we appreciate the fact that the Banking Committee—under your Chairmanship—has kept the door open consistently to the voices of consumer organizations.

With that in mind, Mr. Chairman, let me digress very briefly to State with all sincerity our tremendous disappointment in your decision not to seek another term in the Senate. We have regarded you as a great friend of the American consumer—the record amply supports that conclusion. You will be greatly missed in the next Congress by consumers in every State of this Nation.

### General Background

Today's hearing has a familiar ring. The banking industry is back, knocking on the door for greater geographical and product deregulation—for a bigger slice of the Nation's economy. At the moment, the issues are interstate branching and insurance. But, as we all know, the bank's wish list is long and behind branching and insurance lies securities powers and a myriad of other financially related services.

It seems that bankers are having a hard time simply being bankers these days. CFA is concerned that in the industry's mad rush to be all things to all people the traditional core business of banking—lending and retail deposit taking—will fade in importance and focus, and be relegated to the top shelves of unattended and out of the way aisles in the bankers' financial supermarket dreams.

The diversification trends carry tremendous implications for regulation, economic competition and consumer and community access to banking services. Advocates of renewed bank deregulation argue that allowing banks to branch and enter new financial services areas will increase competition and that this competition will reduce price levels and eliminate excess profits to the benefit of consumers.

However, CFA is not so persuaded. In fact, we believe that the increased industry consolidation and concentration that branching will usher in will increase the cost of basic banking services and may hamper the ability of Federally-insured and subsidized depositories to meet local credit demand. The evidence is less conclusive on insurance sales by banks. However, we are convinced that absent firm and enforceable consumer safeguards, insurance sales could easily become yet another lobby stick-up for consumers.

### Regulatory Modernization Needed First

While the industry speeds ahead with expansion, consolidation, and product innovation, our Nation's regulatory machinery overseeing Federally-insured institutions remains virtually static. Scattered across four Federal and some 50 State agencies, inconsistency, overlapping procedures and conflicting rules reign—all enforced with vastly differing degrees of vigor and independence at great cost to the effectiveness of supervision and the efficiency of regulation. Neither the public interest nor the industry win in our current balkanized and outmoded system.

CFA cannot but note that the banking industry is looking toward the year 2000 and beyond while the regulatory agencies remain mired in a structure that has been pasted together over the last century and a quarter to meet the problems of the moment. We do not think that the present structure is strong enough, sufficiently independent or properly coordinated to deal with the modern era of banking, particularly if the Congress decides to add new products, new markets and allow virtual unlimited expansion to a taxpayer-backed industry.

We urge that the Congress move to restructure, modernize, and consolidate banking regulatory agencies before handing the industry longer reaches in the economy. If there are to be more activities to monitor over a vastly wider geographical area—crossing not only agency jurisdictional lines, but State boundaries—it is essential that we have a consolidated regulatory structure with full independence and a focused mission limited to supervising the banking system.

At the moment, we have two agencies—the Office of the Comptroller of the Currency and the Office of Thrift Supervision—as bureaus in the huge Treasury Department—a department devoted to political policy making in any Administration. Another wing of the Federal regulatory structure is housed somewhere among the 27,000 employees of the Federal Reserve system—an agency more concerned with the economy and monetary policy than the nitty-gritty of bank regulation. And, the Federal Deposit Insurance Corporation—the world's largest insurance company—attempts to balance the roles of insurer, liquidator, conservator, and regulator.

Last February, the General Accounting Office sent reports to this Committee raising most serious questions about the adequacy of examinations carried out by each of these agencies. And those were examinations of existing activities of banks—not any of the new adventures on the drawing boards of the industry's strategic planners.

We are well aware that you, Mr. Chairman, have worked hard to restructure the agencies and Chairman Gonzalez, in the House, has introduced H.R. 1214 to accomplish similar ends. These measures offer excellent ideas for agency consolidation and we think the two Committees would be taking a giant step forward if they turned their energies to melding these two bills into law this Congress—before adding more burden and complexities to the present jerry-built system through new bank expansion. Mr. Chairman, perhaps we can have another Riegle-Gonzalez law that advances the public interest before your departure from the Senate.

Such a consolidation and restructuring, we hope, would end the strange—and we think inappropriate—role that the regulatory agencies too often play as advocates for the industry—sometimes promoting bank wish lists harder than the industry trade associations themselves.

A few weeks ago, Comptroller of the Currency Eugene Ludwig—following the pattern of his predecessors—was out on the hustings laying out the rationale for the entry of banks into insurance and passing out kind words for interstate branching.

We have high regard for the new Comptroller and have praised many of his regulatory initiatives, but he is a regulator—not an advocate. We worry when a regulator is out recommending financial products that he must ultimately regulate. If one of these products, carrying the Good Housekeeping Seal of the Comptroller, goes sour in the marketplace, will the Comptroller be as vigorous and as quick as he should be in sounding the alarms? People have a difficult time killing their own ideas—its just human nature and we should guard against that risk when the Nation's banking system is on the line.

The Executive Branch is well equipped with policy making machinery. If basic changes need to be made in banking law, certainly the political officers—the Secretaries of Treasury and their Assistant Secretaries and economic advisers are quite capable of providing that service—and are seldom timid about doing so. We believe that such advocacy is not the proper role of a regulator and that is why an *independent* regulatory body is so important to the future of bank supervision, banking customers and the health of the industry.

INSURANCE AND INTERSTATE BRANCHING

At the moment, two items—insurance and nationwide branching—are the favorites on the bank tote boards. Both would vastly expand the economic influence of commercial banks over the economy and we believe that both proposals have important implications for consumers and local communities—implications which must be carefully considered by this Committee.

These proposals—like all ideas for new banking activities—CFA believes must be tested for their impact in three areas:

(1) Safety and soundness and the deposit insurance funds;
(2) Consumers and local communities;
(3) The economy, with particular emphasis on competition.

RECENT HISTORY OF BRANCHING

Two years ago, interstate branching was a cornerstone in the Bush Administration's proposals to restructure the financial services industry. At that time, the Nation and the Congress was told that the very existence of the banking system depended on the massive change in the industry—change that would expand the product and geographical horizons of federally-insured and subsidized institutions. Some of the hyperbole of the moment, then, suggested that the taxpayers would be forced to pick up the debris of a wrecked industry unless the Congress opened the flood gates to geographic expansion. Consumers and communities were told to stand aside, drop concerns about safeguards and let freedom ring in the bank board rooms—with all the Government insurance, subsidized loans and guarantees remaining fully in place.

For various reasons, Congress balked. Branching safeguards remained on the law books. Did the industry collapse as the branching advocates had prophesied? No. in fact, last year, the banking industry recorded 32.2 billion in profits—the most profitable year in the history of banking. And, the first and second quarter reports for 1993 show the same record setting trends continuing, unabated, with industry profits likely to exceed $40 billion by year's end.

CFA feels that the stakes—the dangers—are even higher, though, for communities and consumers in a highly concentrated banking industry—concentration that

will be ushered in if interstate safeguards are further relaxed. We believe that consumers should rightfully fear a retail banking industry that is dominated by a handful of giant corporations, setting fees, interstate rates and determining—from centralized far off offices—what banking services are available in their local communities. Low- and moderate-income consumers, already seriously underserved by our Nation's publicly-supported banking system, CFA believes, would be placed at particular risk.

Our concerns about concentration are not romantic. The top ten bank holding companies in the United States today have over $1 trillion in assets and through mergers within regional compacts and emergency acquisitions, these entities already enjoy great political and economic influence in our society. Extending their reach nationwide will further concentrate their banking and political resources. The trend, we believe, bodes ill for credit availability and affordability for consumers, communities, and small business persons—and for the maintenance of a competitive national economy.

Already, through the benevolence of a rubber-stamp anti-trust and merger policy at the Federal Reserve and the Department of Justice, we have banking giants like NationsBank, Bank of America, Norwest and others controlling vast economic resources and extending their reach across dozens of States. And, the weekend newspapers brought reports of a planned merger of two other regional banking powers—Keycorp in upstate New York and society Corporation of Cleveland Ohio—a combination that would create the Nation's 10th largest bank stretching from Maine to Alaska with $55 billion in assets.

The concerns that we retain about interstate branching and the concentration of financial resources within the banking industry are heightened by the consistently negative attitudes and poor performance of the industry toward consumer and community needs. Every consumer safeguard—dating from Truth in Lending in the 1960's—has been opposed by the considerable lobbying forces of the banks. Over the last two years the Federal Reserve Board has released data collected from the industry under the Home Mortgage Disclosure Act (HMDA) that shows that minority customers are two to three times more likely to be denied mortgage credit than white citizens of even the same income. At the same time, banks have conducted a virtual war against the Community Reinvestment Act, a critical lifeline for communities and minority borrowers across the Nation.

When Congress considered the interstate branching legislation in 1991, the industry mounted its heaviest guns to fight anything that appeared close to a safeguard for the consumer—a fact that does not add credibility to the bank's claims that consumers will benefit when a single bank can spread its corporate wings from the Atlantic to the Pacific.

So, the industry does not come to the Congress, today, with clean hands in so far as consumers are concerned.

### Impact of Interstate Branching

There is no end to the claim by the banks about the benefits of interstate branching. No claim is too outlandish to be voiced in some forum. Bank proponents have been quoted as claiming savings of $5 to $10 billion annually for the industry. Consumers, the media is told in interviews with bank executives, will be the beneficiaries of "$50 to $100 billion in newly available credit." Like magic, nationwide branching will cure everyone's ills and banks will be doling out consumer loans on every corner, few questions asked.

However, our analysis of branching to date casts grave doubt on many of the claims of interstate advocates and has convinced us that there are significant anti-consumer consequences in the on going consolidation of the banking industry that warrant further independent investigation and effective regulation.

The fact is that interstate banking, for the most part, already exists today. Authorized under the Bank Holding Company Act of 1956, a holding company can establish bank subsidiaries in States which allow it to do so. Under various regional compacts, all but one State of the union now permit such entry and many holding companies have successfully expanded under the current legal framework. Under today's law, each subsidiary bank of a holding company must maintain its own board and record, file its own regulatory reports, and be subject to applicable Federal and State law regarding safety and soundness, and consumer protection.

Interstate branching, however, would radically alter the carefully crafted balance of our Nation's current banking system. It would eliminate accountability to local communities and economies that subsidiary banks possess and would permit holding companies to operate one central bank, with branches, regardless of State boundaries. CFA believes that the prospect of nationwide branching raises several serious public policy issues—matters that cannot be responsibly ignored.

*Are There Efficiencies in Interstate?*

Bankers claim significant savings can arise from mergers. Hugh McColl, President and Chief Executive Officer of NationsBank, claims his bank could reduce costs by up to $50 million a year.[1] Richard Rosenberg, President and Chief Executive Officer of Bank of America, also believes "keeping separate banks . . . is costing us around $50 million a year."[2]

Many Federal Reserve Bank Studies suggest that the efficiencies these interstate advocates claim do not, in fact, exist. A Federal Reserve Bank of Atlanta study found no evidence non-interest expenses were lower after mergers than prior.[3] This study examined mergers of banks with at least $100 million in assets between 1982 and 1986. Other studies are consistent with this conclusion.[4]

More recent examples show the same story. A look at the Federal Reserve's annual *Functional Cost Analysis* data over the last few years reveals that larger banks created by mergers do not necessarily create more efficient banks (see Table One). Large banks reported it cost almost two dollars more to process an on-us debit in 1991 than smaller banks. As Table One demonstrates, this trend holds true from 1987 through 1991.

Large banks are also inefficient relative to smaller institutions in the areas of processing deposits and cashing checks (Table One). In 1991, smaller banks could process a deposit for approximately forty cents, while a large bank incurred almost forty-four cents per deposit. Check cashing costs reveal the same story. It costs a larger bank almost four cents more per check than a small bank.

A short case study illustrates the shakiness of the claims of interstate advocates. Back in the mid-1980's Citibank started a political campaign in Arizona and convinced the legislature to enact an interstate law that would allow this New York-based corporation to come into the State. There was no end to the claims of what this move would mean for the Sunbelt.

Citibank did move in, swallowed up a few banks in the process—and eventually lost part of its rear end. Earlier this year Citibank sold its 62 branches in the State to Norwest corporation. Based on figures published in the Arizona Republic, Citibank lost $191 million dollars since entering Arizona. And Norwest bought only the good assets, leaving Citibank still holding the delinquent credits.

So much for the glorious claims of Citibank when it raced to take its spot in the Sun in the 1980's.

If, in the end, the Committee somehow concludes that the banks claims of efficiency hold water, we hope that steps will be taken to make certain that these savings are passed on to consumers. If the claims about benefits to consumers from branching are more than the public relations gimmicks of the moment, then these banks should not object to these savings being locked in for the consumers and small business persons. Perhaps, consumers could be given relief from the burden of fees that are making banking a luxury item for low- and moderate-income Americans. Consumers can buy little with bank press releases, but they can cash in if the Committee is willing to get concrete agreements from the banks to support basic banking reforms in this same package.

*Where Do Efficiencies Come From?*

Interstate branching supporters claim the current holding company method is a more costly method of expansion. However, there is grave doubt that branching is a less expensive alternative to expansion under the Bank Holding Company Act. A Federal Reserve study found no evidence supporting the claim a branching system is more efficient than the use of a holding company.[5]

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[1] March 18, 1992 letter sent by Mr. McColl to NationsBank's shareholders.

[2] Klinkerman, Steve. "Wider Branching Welcomed Bust Seen as No Quick Fix." *American Banker*, March 8, 1991, p. 1.

[3] Srinivasan, Aruna and Larry D. Wall. "Cost Savings Associated with Bank Mergers," Federal Reserve Bank of Atlanta. Working Paper 92–2. February 1992.

[4] Berger, Allen and David Humphrey. "The dominance of inefficiencies over scale and product mix economies in banking." *Journal of Monetary Economics* 28 (1991) 117. Also: Linder, Jane and Dwight Crane. "Bank mergers: Integration and Profitability." Harvard Business School, February 5, 1992. Also: Rhoades, Stephen and Donald Savage. "Interstate Branching: A Cost-Saving Alternative?" *The Bankers Magazine*, July/August 1993, p. 34. Also: Rhoades, Stephen. "The Operating Performance of Acquired Firms in Banking before and after Acquisition." Board of Governor's of the Federal Reserve. April 1986. Also: Rose, Peter. "Interstate Banking: performance, market share and market concentration issues." *Antitrust Bulletin*, Fall 1992, p. 601.

[5] Rhoades, Stephen and Donald Savage. "Interstate Branching: A Cost-Saving Alternative?" *The Bankers Magazine*, July/August 1993, p. 34. Also: Rhoades, Stephen. "The Relative Operat-

Continued

Bank One Corporation, which operates in 7 States with 36 separate banks and 737 branches, does not believe interstate branching provides any significant benefits. "Our feeling is that and independent bank with and independent president serving the community creates value which more than offsets the increased expenses of maintaining separate entities," states its Senior Officer.[6]

Bank One exemplifies how strong management is the most important aspect of a bank's efficiency. You might say that "It's management, stupid." Bank One's return on assets was 1.34 percent in 1992, higher than all but two of the largest twenty-five banking companies in the country. Their return on equity was 16.3 percent, sixth highest in their peer group. Clearly, a successful bank holding company is not unattainable.

The evidence suggests that management is more important than size in cost cutting. In a study categorizing banks by size and analyzing their cost structure,[7] significant variances were found between bank's costs within the same size class—these variations were considerable. The conclusion: a bank does not have to be large in order to be efficient. Strong management is more important to being efficient than size.

*Will Interstate Branching Increase Competition or Concentration?*

Interstate branching would allow banks to enter new markers anywhere in the country. While proponents claim this increases the potential for competition, interstate branching may in fact reduce competition.

As banks have expanded geographically, the overall number of banking organizations has declined. In the long run, the number of potential banks to be bought will decrease and a small number of large institutions will likely dominate the marketplace.

An example of *intra*state branching provides insight to this increase in concentration. California, because of its size and long history of intrastate branching, is suggested as an example of nationwide branching. But, in California, a handful of large banks control the marketplace. Bank of America, First Interstate, and Wells Fargo hold over $170 billion in deposits—over 50 percent of the deposit base of the commercial banks in California. Permitting branching on the *inter*state level, CFA believes, would further promote the concentration of large financial institutions and decrease competition.

*What Is the Impact of Increased Concentration?*

If consolidation occurs on a national level similar to what has transpired in California, a few banks will have a sizable market share. This market power directly translates into considerable benefits for the banks—but, little, if any, benefit for consumers.

Several Federal Reserve studies have analyzed the relationship between price and concentration in banking markets.[8] These studies have found higher loan rates in markets which are more concentrated. For example, Federal Reserve economist Stephen Rhoades concluded his study of mortgage rates in twenty cities with the following: "the results suggest that market concentration, as measure by the Herfundahl index, affects the prices charged in local markets for mortgages."[9]

Other Federal Reserve studies have found deposit rates are lower in markets with higher concentrations.[10] One study in particular found that rates on money market accounts and NOW accounts in California, a State with a long history of branch banking, to be below the national averages.[11] Berger and Hannan conclude their study of the price-concentration relationship with the following observation: "Banks in the most concentrated local markets in the sample are found to pay MMDA rates

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ing Costs of Multibank Holding Companies and Branch Banks." Board of Governors of the Federal Reserve. January, 1992.

[6] Supra note 4.

[7] Berger, Allen and David Humprey, "The dominance of inefficiencies over scale and product mix economies in banking." *Journal of Monetary Economics* 28(1991)117.

[8] Hannan, Timothy H. "Bank commercial loan markets and the role of market structure: Evidence from surveys of commercial lending." *Journal of Banking and Finance*, Vol. 15, No. 1, 1991, p. 133. Also, Rhoades, Stephen A. "Evidence on the size of Banking Markets from Mortgage Loan Rates in Twenty Cities." Board of Governors of Federal Reserve System Staff Report 162, February 1992.

[9] Rhoades, Stephen. "Evidence on the Role of Banking Markets from Mortgage Loan Rates in Twenty Cities." Board of Governors of Federal Reserve System, February 1992.

[10] Berger, Allen an Timothy Hannan. "The price-concentration relationship in banking." Board of Governors of Federal Reserve System, April 1988.

[11] Neuberger, Jonathan and Gary Zimmerman. "Bank Pricing of Retail Deposit Accounts and 'The California Rate Mystery'." Federal Reserve Bank of San Francisco *Economic Review*, Spring 1990, No. 2, p. 3.

that, depending on the time period examined, range from 25 to 100 basis points less than those paid in the least concentrated market."[12]

Also, studies have found that in concentrated bank markets price rigidity has been exhibited—i.e., that banks in concentrated markets were slower to reduce loan rates when the national market was falling. These banks also lagged behind the country in raising deposit rates.

The concern here is that as the number of firms in a market is reduced, competition is reduced. The structural reduction of competition leads to conduct which is not disciplined by market forces. Firms exercising their market power will be able to engage in exploitive pricing practices—unjustified price discrimination, above all else—because they are unchecked by competition. The performance of the banking market would deteriorate producing inefficient and socially undesirable outcomes.

We must note here that the performance of the Department of Justice in examining the anti-trust implications of bank mergers has been woefully inadequate. Current guidelines for DOJ analysis of the competitive effects of mergers rely on the calculation of market share. However, DOJ's definition of banking market share is both vague, non-standard and biased toward increased concentration. In fact, DOJ staff have admitted that bank markets can be so poorly defined as to have been lifted right off a Rand McNally atlas—hardly the rigor of analysis the public should be granted in the critical area of financial markets.

Interstate branching will encourage bank expansion and concentration. An increase in banking concentration will result in significant pricing power for the remaining banks—at the expense of consumers. The empirical data suggests that consumers will incur greater costs when borrowing and receive lower return on deposits.

*Will Interstate Branching Decrease Customer Fees?*

CFA is particularly concerned that interstate branching would subject consumers to ever larger levies from big banks for day today essential financial transactions. Interstate branching and the mergers and consolidation it would encourage would eliminate competitors. This reduced competition would allow the larger banks to price services in anti-competitive manners.

Data from the American Bankers Association's Retail Banking Reports indicate large banks already charge customers more than their smaller counterparts do. (See Attachment A.) Bigger banks charge higher monthly maintenance fees on regular checking accounts and larger banks charge more per check. According to the trade groups own data, this has been true from 1987 to 1991.

Bigger banks typically have higher minimum balance requirements for consumers to avoid charges. They also charge more to maintain accounts, charging an average of $2.75 a month for a basic/no-frills account, while small banks charge an average of $2.50.

In its most recent Annual Report to Congress on Retail Fees and Services of Depository Institutions, released last month, the Board of Governors of the Federal Reserve confirmed our own Consumer Federation of America report on the alarming increases in fees consumers are charged for basic household deposit accounts.[13] The Annual Report summarized their findings, saying "A trend in the direction of higher fees readily apparent for both (large and small) types of institutions." Our CFA survey found that fees banks charge for deposit accounts have been increasing at a rate more than double that of inflation over the past 3 years and that increases are steepest at the largest institutions.

Examining both the functional Cost Analysis and the ABA Retail Banking Report, it is clear large banks have raised fees in recent years at the same time that have remained virtually unchanged (Table Two). Monthly fees increased 18 percent from 1988 to 1991, while account maintenance costs have actually declined one percent.

A recent *Wall Street Journal* article provides some insight into the price consumers will pay if more bank mergers are encouraged by interstate branching.[14] (Attachment B.) The Headline: "A Bad Buy? BankAmerica Finds It Got a Lot of Woe with Security Pacific."

After failing to reach the Atlantic through the purchase of the Bank of New England, Bank of America rushed headlong into hasty, but successful merger talks with its peer bank Security Pacific and acquired a massive reach up and down the West Coast. Now that press releases are beginning to yellow, the deal looks less like one

[12] Supra note ii.

[13] "Annual Report to the Congress on Retail Fees and Services of Depository Institutions." Board of Governors of the Federal Reserve System. June, 1993.

[14] King Jr., Ralph T. "A Bad Buy? BankAmerica Finds It Got a Lot of Woe with Security Pacific." *Wall Street Journal*, July 22, 1993.

of the wonders of the banking world than a discarded lottery ticket. Bank of America has underperformed its peers over the past year and has had to write off large amounts of unforeseen losses. In addition, company morale is poor and 10,000 jobs have been eliminated throughout the western United States.

The newspaper quoted various gloomy reports from financial experts, but some analysts chipped in which the potential secret of how Bank of America would recoup its interstate mistakes—it would just stick it to the consumers.

Let me quote from the Journal:

*"Analysts expect the bank, using its market clout, eventually to find ways to bombard consumers with fees."*

"To bombard consumers with fees . . ." That, Mr. Chairman, may be the underlying and closely held dirty little secret of how banks plan to make interstate branching profitable—on the backs of consumers with a bombardment of fees.

*Will Interstate Branching Increase Credit Availability?*

Small business and consumers rely on local banks to meet their financing needs. Large corporations can access national banks and the financial markets to obtain their financing. Several studies have tested this and found small business and consumers must look to local markets for their banking need.[15]

Interstate branching will promote large banks, with centralized operations. This removal of power from the local level reduces the decision-making authority of branch managers and will decrease the accountability of a banking corporation to the needs of local communities.[16] When a central office processes loan applications, decisions are more likely to be based on numerical credit scoring and less on the unique qualifications of the applicant.[17] Banks often have difficulty understanding that diversity is strength, not a weakness. Absentee decisions, inevitable in a nationwide branching system, will only make this unfortunate trait worse and more destructive.

The centralization of bank operations has other harmful consequences as well. A 1990 study on the impact of financial deregulation in New England found that branch banks offered fewer of the services small business depend on—such as counseling and referrals—and tended to emphasize services that benefit larger firms—such as cash management, asset lending and leasing.[18] Another survey of small businesses found smaller banks provide better services than larger banks.[19]

The *Journal* story, noted above, uncovered the same bias against small business. It found borrowers—former customers of Security Pacific—who had, in effect, been shunted aside by Bank of America. Companies like U.S. Filter Corporation and Men's Wearhouse told *Journal* they switched to other banks elsewhere in the Nation because of the treatment by Bank of America. Obviously, these companies were large enough to have options—the ability to gain acceptance from out of State banks. But, what happens when an interstate operation clobbers the small business person—the family operating a hardware store or a corner grocery store? They don't have the freedom and they aren't going to be accepted by some large bank located thousands of miles away. They have to accept what the interstate operative gives them or trot to the bankruptcy court.

*Will Interstate Branching Aid Economic Development?*

Because they operate in multiple areas, interstate banks have the ability to allocate capital wherever demand exists in developing local economies. For example, a bank can collect deposits in Texas and make loans in Florida, if that is where the demand is. Proponents claim this is the efficient allocation of capital. However, this efficiency, in this example, comes at the expense of Texas.

By reducing the loanable funds available in Texas, any economic downturn will exacerbated, perpetuated, and prolonged. An economic boom in Florida will be enhanced while a recession in Texas deepens. The so-called "efficiency" in Florida comes at the expense of the local economies in Texas.

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[15] Elliehausen, Gregory and John Wolken. "Banking Markets and the Use of Financial Services by Small- and Medium-sized Business." *Federal Reserve Bulletin*, September, 1990, p. 726.

[16] Markey, Deborah. "The Impact of Deregulation on Rural Commercial Credit Availability in four New England States: Empirical Evidence and Policy. Implications." May, 1990.

[17] Ibid. Also: Dennis, William, William Dunkelberg and Jeffrey Van Hulle. "Small Business & Banks: The United States." NFIB Foundations, 1988.

[18] Supra note 16.

[19] Supra note 17.

A Staff Report of the House Banking Committee, released in March of 1992, found firm evidence that interstate banks do remove funds from certain States.[20] This study examined the largest fifteen bank holding companies with interstate operations. Seven of the holding companies removed funds at least half of the States where they owned subsidiary banks.

No geographic or economic pattern emerged from removal of funds, suggesting there was no efficient allocation explaining why funds were leaving one State and entering another. The only pattern which emerged was that the drained funds ended up in the home State of the holding company.

The study's conclusion: Large holding companies demonstrate a lack of commitment to many of the communities they operate in. Draining of funds can and does occur under current geographic restrictions. Interstate branching would only facilitate the ability to move local deposits hinder a local economies. Drained deposits hinder a local economies' ability to recover and extend the downsides of economic cycles. The lack of information of the subject of "deposit siphoning" suggests the dire need for much greater study.

*Does Interstate Branching Give the Consumer a Safer System?*

Interstate branching will reduce the number of subsidiaries a bank controls. Currently, each of these subsidiaries must file separate regulatory reports, have separate examinations, and meet separate capital requirements.

In 1991, NCNB, now NationsBank, said they could reduce the number of reports filled by almost 15,000 are not useless. Separate reporting provides regulators, security analysts, and consumers with information regarding the financial condition and social performance of each NationsBank's subsidiaries.

Currently, regulators can isolate problem areas within a holding company by each State of subsidiary operation. By combining each subsidiary into one report, numbers rapidly lose their meaning. It will become extremely difficult to identify problem areas if nine or ten different State reports are combined into one. Interstate branching will reduce the information available and make it difficult—if not impossible—for regulators to effectively supervise large interstate institutions.

In particular, the walls that now exist between bank subsidiaries permit regulators to monitor the movement of capital between the holding company and various subsidiaries. Elimination of these distinctions will make in more difficult to detect a bank's use off subsidiary capital to subsidize other operations within a holding company.

For example, a cash flow analysis of Norwest Corporation revealed that subsidiary bank earnings—particularly those that had been recently acquired by the holding company in the State of Iowa—were being used to support the lead bank in Minnesota as well as finance non-bank activities far from the communities of the subsidiaries.[21]

CFA is particularly concerned that interstate branching could permit undercapitalized banks—as the Norwest Corporation was at the time of this analysis—to branch into new communities and remove local deposits and the earnings derived from local banking markets at the expense of serving local communities.

Finally, by encouraging ever larger banks, interstate branching could well undermine recent reforms to retire the too-big-to-fail regulatory doctrine that has ailed the Federal deposit insurance system for over a decade. This implicit guarantee and subsidy to mega-banks only encourages risk-taking, since large banks have little to lose at the roulette table of high finance.

BRANCHING RECOMMENDATIONS

Mr. Chairman, CFA believes that this Committee must concentrate on building a solid network of consumer and small business and community protections before banks are given a free pass into the never never land of interstate branching. These safeguards must be up front. Too much is at stake for them to be passed off to some other Congress at some other time.

There are many safeguards to be considered if the public is to be protected—some were included in S. 534 as reported by the Committee, most were not.

Should the Committee, in its wisdom, decide to open the doors to geographic deregulation and grant giant financial corporations the benefit of interstate branching, we urge that the Committee adopt, at a minimum, the following safeguards:

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[20] Staff Report to Committee on Banking, Finance, and Urban Affairs, House of Representatives, One Hundred Second Congress. "Analysis of Banking Consolidation Issues." March 2, 1992.

[21] "Cash Flow Analysis: Norwest, A Case Study." The Bank Monitor, October, 1990.

(1) *Maintain existing safety and soundness and consumer protection measures.*

(a) Evaluations of insured depositories for compliance with the Community Reinvestment Act (CRA) must be kept in step with any new world order of interstate branching. CRA evaluations must be conducted on a MSA-by-MSA basis for all interstate institutions.

(b) Similarly, Reports of Condition—Call Reports—for interstate institutions must ensure a State-by-State breakout of essential safety and soundness and social performance data. It would be a literal nightmare for regulators, financial markets, and the general public alike if multistate banking corporations' Call Reports were consolidated into the dark recesses of single nationwide reports.

(2) *Prohibit expansion for undercapitalized institutions.*

No undercapitalized bank should ever be granted the benefit of interstate branching. Failure to include such prohibitions would invite the pilfering of a local banking assets.

(3) *Establish firm concentration limits.*

Strict concentration limits should be written into statute to prevent anti-competitive market distortions. Concentration limits must be established that guarantee competition in local banking markets. The application of arbitrary political boundaries to analyze anti-trust implications of bank expansion are not adequate substitutes for real world definitions of bank markets.

(4) *Deny expansion opportunities to exclusionary banks.*

No publicly-insured institution should be granted branching benefits if it has a record of discriminatory lending patterns, a record of opening or closing branches in a manner that tends to exclude low- and moderate-income communities, or has less than a satisfactory CRA rating.

(5) *Guarantee adequate administrative procedure.*

Public hearings should be mandatory on all interstate applications and "community due diligence requirements" should be a required part of all branching applications.

(6) *Ensure proper reporting and regulatory supervision.*

(a) Regulators must be required to monitor and collect sufficient data on deposit and earning flows to ensure that branching is banking—safe banking—and not just an upstreaming of deposits and earnings that impair the ability of branch facilities to meet local community banking needs.

(b) Excessive escalation of retail account fees must be checked and regulators should be required to monitor and publicly disclosure consumer account fees of interstate institutions.

(7) *Preserve State consumer protection law.*

There can be no Federal preemption of State laws on community investment, fee restrictions and other consumer protections. All State consumer protections must apply to interstate branches regardless of the mailing address of the charter. The broad protection that the Douglas amendment now provides consumers should be retained.

(8) *Protect local economies by mandating forward CRA commitments.*

To guard against the possibility of diminished availability of local banking services, forward CRA commitments that are aggressively monitored and enforced by Federal regulators should be mandatory components of every interstate application.

BANK SALE OF INSURANCE

The sale of insurance, as the Committee knows well, is one of the oldest and hardest fought issues—the sources of bitter battles between the insurance industry—particularly the insurance agents—and the banks for decades.

We tend to agree with the banking industry—and Comptroller Ludwig—that the of selling insurance does not pose any large identifiable risks to safety and soundness perhaps with the notable exception of title insurance. We would give the proposal a passing grade on this point—unless, of course, the activity became so pervasive, so profitable, and so dominant as to detract from management's emphasis and the internal controls of banks relating to their primary role in providing credit and banking services.

But, would banks' ability to provide insurance help consumers and communities?

CFA believes that the answer to this question is dependent on both the manner in which banks may be permitted to sell insurance—with or without adequate

consumer safeguards—and the specific lines of insurance permitted to be peddled through insured institutions.

It is true that there are many neighborhoods and communities where insurance services are sparse, where premiums are high and quality low, and where minority consumers, in particular, have extreme difficulties in securing insurance protections. We are pleased to see that the House Banking Committee and the Energy and Commerce Committee have both reported legislation in the last few weeks to monitor and combat the practice of redlining of insurance services in urban communities.

So, this would seem a fertile ground for the banks entry into the insurance market. But, these neighborhoods—redlined for insurance services—are the very same neighborhoods most often redlined and discriminated against by the banks in the granting of credit. The HMDA data on mortgage lending and the available studies of geographical distribution of insurance services are almost identical—they seem to be lifted from the same map.

So, in this area, the two industries seem to be in a tie for last place.

Then, does the entry of banks into the insurance business mean more competition—long-term competition or short-range entry-level competition?

Banks hang much of their argument on this issue of competition and the contention that competition will bring more services, more choices, lower prices, fewer excess profits—all of which benefit the consumer.

In 1987, CFA released a detailed study of savings bank sales of life insurance and found that consumers did benefit from the market presence of banks in the sale of this type of insurance. Savings banks tended to offer both lower priced policies and tended to be more responsive to consumer requests for information than competitors in the insurance industry. So, in the area of life insurance, their may well be benefits to bank entry into the marketplace.

But, it is dangerous to generalize from the experience in life insurance to all forms of insurance—particularly insurance lines that are associated with credit transactions like homeowners, title insurance, and many commercial lines.

Banks do occupy a special and somewhat protected niche in the economy and, despite new competition in the higher atmosphere of financial services, they retain a largely captive audience—particularly at the consumer and small business level where basic banking services are still akin to water and air for day-to-day survival.

Credit life insurance is an example of an industry-wide adventure by lenders into the insurance field. This trailblazing effort has turned out to be a disaster for many consumers. Studies, including those conducted by the Federal Reserve, have revealed significant levels of credit life insurance sales abuses arising from coercion of the borrower. CFA has often decried the practices in the credit life industry as "the Nation's worst insurance ripoff." We have estimated that consumers have been overcharged nearly $1 billion annually for this insurance—insurance that few consumers need.

In many cases, consumers are not even aware that credit life insurance have been added to the credit transactions. The belief that something besides good old free market forces are at work is buttressed by the fact that credit life insurance sold through lenders has often been as much as 40 percent more expensive than comparable coverage sold elsewhere—price inflation that is fostered by rampant "reverse competition" among lenders and insurance underwriters.

Admittedly, the exposure of the abuses has brought reforms by the lending industry, but studies in recent years suggest that the problem still exists for many, particularly among low-income and poorly educated borrowers.

CFA believes that when considering insurance—or any new product—it is important that the Congress recognize that the banks' primary product—credit—is a powerful tool in the marketplace—a volatile commodity that can become destructive to competition when improperly combined with other elements in the economy. Coercive tying in credit transactions is an ever present risk for both consumers and business borrowers—a risk that can distort forces of market competition and lead to abusive price gouging.

Borrowers sitting on the edge of their chairs—hoping that the loan officer will say yes to that new Chevy, Ford or import—are very susceptible to the slightest suggestion that they consider other products on the bank's menu. The same is true—even more so—for the family hoping for an okay on a mortgage. Even for the most creditworthy and experienced there is a feeling of intimidation, knowing that the banker holds all the cards for their hopes of home ownership or business expansion. The borrower wants to please at this moment—and if that means signing on to the bank's insurance plan, rest assured the policy is purchased without a whimper.

And think of the car dealer who depends on the local bank to finance the floor plan—the new car inventory. Isn't that dealer likely to place the bank's insurance form on top of the stack when the customer is asked for coverage on the new car.

This is an area that does leave the insurance agent at a disadvantage—the potential for tie-ins with a credit transaction. Yes, the Bank Holding Company Act prohibits tying of other products with the credit transaction, but this has proven difficult to detect and police, and probably impossible to prevent in the real world of banking—unless we had examiners sitting at the loan table for every credit transaction.

So, competition may be increased when banks first enter the insurance arena. But will their advantage—credit—ultimately drive competition from local markets? In some markets will the local banker end up being the only source of insurance for the consumer?

CFA's studies of banking practices at the retail level raise other concerns about consumer products marketed by banks. Increasingly, banks are applying surcharges—fees—to every item sold to a consumer—checking accounts, ATM machines, cashier checks, wire transfers, routine telephone inquiries—the list is endless.

In recent years, these fees have increased dramatically and are becoming a significant profit center for many banks. Few, if any, of these charges are based on costs—they are arbitrarily applied whenever or wherever the earning figures needs shoring.

This treatment of what the banks consider to be a market of captive consumers does not send out great signals about how customers would be treated if the banks were given a bigger share of other retail markets—such as insurance.

Thus, CFA is concerned that expanding bank insurance powers could increase the range of financial transactions subject to implicit tying and the domination of market participants who could exercise considerable anti-competitive market power. An increase in such tying will reduce—not increase—competition in the provision of financial services—a result counter to the interests of consumers.

INSURANCE SALES RECOMMENDATIONS

If banks are to be allowed to sell insurance, they should also be willing to meet minimum sales standards that are clearly in the consumers interest. This will not only ensure that banks respond to consumer needs, but will create a force for positive change within the insurance industry more generally.

We believe that there are four general areas that the Committee should craft insurance sales safeguards:

(1) *Safety and soundness.*

If bank safety and soundness are a primary public policy concern, then limits on the magnitude of insurance activities should be imposed. This will help ensure that insurance activities do not dilute or otherwise overtax bank management that could detract from safety and soundness.

(2) *Tie-ins.*

In order to curb against bank use of their control over other financial transactions to coerce consumers into buying insurance from them a number of safeguards are in order:

(a) an explicit prohibition against tie-ins;

(b) a cooling off period of not less than ten days after purchase of a bank insurance policy during which a consumer may cancel the insurance without penalty;

(c) the stipulation that an equivalent policy must be acceptable to the lending institution;

(d) preclusion of an offer insurance prior to conclusion of a transaction which is to be covered by the insurance;

(e) prohibition on the use of customer information obtained for a credit transaction without written consent from loan applicant after approval of credit application.

(3) *Disclosure.*

Consumers should also be guaranteed that banks will provide adequate information on the terms, benefits, and costs of any insurance policy in the following areas:

(a) non-FDIC insured status;

(b) price, commissions, expected benefits as a percent of premium and financial ratings of underwriter.

(4) *Physical separation of activities.*

The sale of insurance products should also be conducted in a clearly delineated physically separate location of the financial institution.

Finally, given the continuing problems in the credit life insurance market we believe that legislation should require the most recent loss ratio and overhead ratio (including commissions), of the underwriter to be disclosed.

It is clear that consumers are not well served by the current insurance delivery system. Bank entry into insurance sales could—if, and only if, properly structured with sound consumer safeguards—benefit consumers and drive the industry to perform better as a whole.

## Conclusion

In conclusion, Mr. Chairman, banking is changing and it will clearly continue to reach into new areas of the economy—with or without the aid of the Congress. And this raises new and serious challenges for the regulatory structure.

We fear that the industry may gain acceptance of much of its long wish list before the Administration and the Congress have in place a modern regulatory structure—an independent coordinated body focused on the mission of regulation. Once again, we urge that the Congress reorganize the regulatory machinery before banks expand further in terms of products and geography.

Most of all, Mr. Chairman, we believe that this Committee should enter the arena of interstate branching and bank sale of insurance with great care and with knowledge before the fact.

This is particularly the case with branching. There have been far too many claims—too many wild statements—about branchings' savings and benefits. The Committee needs to seek independent data on these subjects and not accept self-certifications by the banks. We understand that you have asked the General Accounting Office to examine this matter and we hope that the Committee will postpone action on legislation until such independent information has been presented to it.

We emphatically urge the Committee to write solid airtight consumer protections into any legislation granting new powers and new geographical territories for the banking industry. These protections should be up front, not after the fact—not after consumers have been clobbered in the marketplace and sold a quality deficient bill of goods once again.

Thank you for the opportunity to testify.

Table One

Cost to Process an On-Us Debit (cents)

| | | Small | Large |
|---|---|---|---|
| Year | 1986 | 15.34 | 17.65 |
| | 1987 | 17.80 | 21.11 |
| | 1988 | 18.08 | 21.62 |
| | 1989 | 19.66 | 21.71 |
| | 1990 | 19.00 | 22.41 |
| | 1991 | 19.47 | 21.31 |

Cost to Process a Deposit (cents)

| | | Small | Large |
|---|---|---|---|
| Year | 1986 | 31.50 | 36.27 |
| | 1987 | 36.53 | 43.39 |
| | 1988 | 37.12 | 44.44 |
| | 1989 | 40.42 | 44.63 |
| | 1990 | 38.73 | 46.06 |
| | 1991 | 40.01 | 43.80 |

Cost to Cash a Check (cents)

| | | Small | Large |
|---|---|---|---|
| Year | 1986 | 28.13 | 31.40 |
| | 1987 | 33.41 | 37.65 |
| | 1988 | 32.90 | 39.11 |
| | 1989 | 36.10 | 39.31 |
| | 1990 | 34.70 | 41.26 |
| | 1991 | 36.12 | 40.40 |

Small=Banks with assets less than $50 million
Large=Banks with assets greater than $200 million

Source: <u>Functional Cost Analysis: Commercial Banks</u>

Table Two

Costs and Fees at Large Banks 1988-1991

| | | % Change |
|---|---|---|
| Costs: | On-Us Debit | - 1 % |
| | Deposit | - 1 % |
| | Transit Check Deposited | - 1 % |
| | Account Maintenance | - 1 % |
| | Check Cashing | + 3 % |
| | Offical Check Issued | - 1 % |
| Fees: | Monthly Fee | +18 % |
| | Per Check Fee | +52 % |

Source: <u>Functional Cost Analysis: Commmercial Banks</u>
<u>ABA Retail Banking Report: Peer Performance Survey</u>

Attachment A

Comparison of Fee Charges at Large and Small Banks

Source: American Bankers Association's Retail Banking Reports
1988-1992

Regular Checking Accounts:
* In 1989 and 1990, small banks' minimum balance to avoid fees on regular checking accounts was $300, compared to the big banks' $500. In 1991, small banks raised their minimum balance to $500.

* From 1987-1991, the median monthly maintenance fee on regular checking accounts at big banks was higher than at small banks.

* In 1990 and 1991, a greater percentage of small banks than large banks provided unlimited free checks.

* From 1987-1991, the median per check fee was higher at big banks than at small banks.

* In 1990 and 1991, a greater percentage of large banks than small banks charges a per check fee for all checks cashed.

NOW Checking Accounts:
* In 1989, small banks' minimum balance to avoid fees on NOW checking accounts was $800, compared to big banks' $1000. In 1990 and 1991, small banks' required balances were $1000 also.

* From 1988-1991, the median monthly maintenance fee on NOW checking accounts at big banks was higher than at small banks.

* From 1987-1990, the median per check fee was higher at big banks than at small banks.

* In 1991, a greater percentage of big banks than small banks provided no free checks.

Basic/No-Frills Accounts:
* In 1991, 10% of big banks' checking accounts were basic/no-frills accounts, compared to 25% of small banks' accounts

* From 1988-1990, a greater percentage of big banks required a minimum initial deposit for basic/no-frills accounts, compared to small banks.

* In 1990, big banks required a minimum fee-avoidance balance of $500 or an average balance of $600 in basic/no-frills accounts, compared to small banks' $300 and $400.

* From 1987-1991, a much higher percentage of big banks charged a monthly fe on basic/no-frills accounts, regardless of balance maintained, compared to small banks.

Basic/No-Frills Accounts (continued):

* In 1991, big banks charged a monthly maintenance fee on basic/no-frills accounts of $2.75, compared to $2.50 at small banks.

* From 1987-1991, a much smaller percentage of big banks than small banks offered maintenance fee-free basic/no-frills accounts.

* From 1987-1991, a much higher percentage of small banks provided unlimited free checking for basic/no-frills account holders.

* From 1987-1991, a much higher percentage of big banks than small banks allowed only a limited number of free checks per month.

* From 1987-1990, big banks allowed only eight free checks per month for basic/no-frills account holders; small banks allowed ten.

* From 1987-1990, big banks charged $0.50 per check cashed above the number provided free per month. During the same period, small banks' fees averaged $0.26 per check.

* In 1991, 19.5% of big banks charged a fee for all checks written by basic/no-frills account holders, compared to 10.7% of small banks.

Savings Accounts:

* From 1989-1991, the minimum fee-avoidance balance required by big banks on statement savings accounts was higher than the balance required by small banks.

* From 1988-1990, the monthly fee charged by big banks on statement savings accounts was higher than the fee charged by small banks.

* In 1989 and 1990, the minimum fee-avoidance balance required by big banks on passbook savings accounts was higher than the balance required by small banks.

* From 1988-1990, the monthly fee charged by big banks on passbook savings account was higher than the fee charged by small banks.

Attachment B

07/22/93
WALL STREET JOURNAL

A Bad Buy?
BankAmerica Finds
It Got a Lot of Woe
With Security Pacific
---
In Rapid Acquisition's Wake,
Return on Assets Lags;
But It Still Defends Deal
---
An Explosive Culture Clash
----
By Ralph T. King Jr.
Staff Reporter of The Wall Street Journal

SAN FRANCISCO -- BankAmerica Corp., which lent its way into trouble in the 1980s, is finding it also can buy trouble.

In April 1991, BankAmerica Chairman Richard Rosenberg missed a possible coup, a chance to acquire Bank of New England Corp. Determined not to miss the next one, he entered negotiations a few months later with Security Pacific Corp. and emerged, unusually quickly, with an iron-clad deal.

Although it was the biggest bank merger in U.S. history, negotiating it took less than a month. A few BankAmerica aides, holed up in Los Angeles hotels under assumed names, barely had time to skim through Security Pacific's books.

In addition, Mr. Rosenberg persuaded Security Pacific Chairman Robert Smith to hold off other prospective suitors and to reject competing offers once the deal was announced. Mr. Smith agreed, on the condition that under virtually no circumstances could BankAmerica back out of the deal or revise the $4.6 billion price.

That remarkable concession, coupled with equally remarkable misjudgments about Security Pacific's weaknesses, has helped blight Mr. Rosenberg's coup in only two years. A series of post-merger loan write-downs and other nasty surprises, such as unauthorized and possibly illegal use of customer funds in a New York-based trust unit, has triggered accounting charges of $3.5 billion. The charges have raised the effective purchase price to $8.1 billion, adding pressure to cut costs and eroding capital needed for further expansion. The key measure of operating efficiency, return on assets, hasn't budged, in contrast to a 39% surge at Chemical Banking Corp. since its December 1991 merger with Manufacturers Hanover Corp.

Thomas Hanley, a First Boston analyst who at first called the merger "brilliant," now considers it a "disappointment." He notes that BankAmerica's stock is up only 12% since the deal was struck, while other regional banks' shares have risen an average of 40%.

BankAmerica's second-quarter earnings are due to be released today and analysts expect them to be flat, in contrast to strong gains posted by the bank's main competitors. BankAmerica officials say the stock has lagged because of California's recession and because the merger has confused investors and distracted employees caught up in its aftermath.

Indeed, BankAmerica has forced out so many former Security Pacific officials that some assail it as "ethnic cleansing." What was initially structured and portrayed as a merger of equals has degenerated into what many on the Security Pacific side consider an after-the-fact hostile takeover.

Nevertheless, BankAmerica has clearly assembled an awesome franchise, one that could pump big profits once the economy strengthens. Through 1,959 branches, the nation's second-largest bank serves more than half of California's households plus consumers in nine other Western states. It calculates that it elicits 65 million "customer touches" a month.

Analysts expect the bank, using its market clout, eventually to find ways to bombard consumers with fees. Although a lot of stock was issued in the merger, Merrill Lynch thinks the bank's per-share profit slump will end later this year, rising 9% to $5.30 in 1993 and 17% to $6.20 next year. Earnings might rebound even further if BankAmerica over-reserved for the merger costs, as it did with loan losses in 1980s.

In an interview, Mr. Rosenberg, a jovial man known for his marketing savvy, talks of consumer banking's new frontiers, of mutual funds and insurance, of interactive-banking services, of branches coast-to-coast. He contends that it is too soon to evaluate the merger, although he says the cost savings, expected to hit $1.2 billion annually in 1995, are ahead of schedule.

"The real test is going to come in the ninth inning, and we are probably in the third," Mr. Rosenberg says, adding that he wasn't blindsided by Security Pacific's problems but by the severity of the recent recession, "along with everyone else."

Yet the disparity between BankAmerica's post-merger results and those of competitors during the same recessionary period suggests to some that BankAmerica failed to fully comprehend Security Pacific's condition. That failure may have flowed, in part, from the stark differences in the two banks' corporate cultures. BankAmerica has been centralized, rule-bound and ultra-conservative since its mid-1980s loan debacles; Security was decentralized and freewheeling.

Even during the eight months needed to obtain regulatory approvals and put the merger into effect in April 1992, signs of trouble began popping up: little red flags that had gone unnoticed during the once-over-lightly search for big red flags while the deal was being cemented.

Some Security Pacific loans never should have been made at all. HAL Inc., Hawaiian Airlines' parent, had borrowed about $125 million by virtue of HAL investor Peter Ueberroth's friendship with the bank's late chairman, Richard Flamson, and contrary to lending officers' advice. BankAmerica knew that that loan would be largely written off, but the bank should have taken it as a signal of Security Pacific's haphazard approach to lending.

In addition, Security Pacific, unlike BankAmerica, had bet heavily on commercial real estate, which was just beginning to turn sour. Among its big problems, a former official says, were speculative land loans to developers such as William Lyon and George Argyros.

Credit controls were surprisingly weak in Security Pacific's many

autonomous lending units. For example, Northern Automotive, a now-struggling auto-parts chain, had circumvented normal lending limits by obtaining loans totaling $25 million from three separate Security Pacific units. Some loans had so little supporting documentation that they were classified as uncollectible, according to one manager who says he personally found at least $100 million of such deals.

A dozen lawyers spent months deciding how to handle each of several thousand lawsuits and setting up reserves for them, says Winslow Christian, a former BankAmerica attorney. The bank quickly settled some longstanding suits. One lender-liability suit, brought in 1989 by Inovision Corp. (formerly Vestron Inc.), was settled for $100 million, according to Inovision, far more than BankAmerica had projected.

Embarrassing disclosures have become almost routine. In March, BankAmerica said Security's personal-trust department had improperly overcharged some customers, a practice that it said would cost $50 million to straighten out. In April, BankAmerica acknowledged "possible violations" of pension-fund management laws at Sequor Group, Security's New York-based corporate-trust operation. BankAmerica says regulators are investigating but it deems regulatory action unlikely. It has removed more than 30 Sequor managers and announced a $3 million refund to some Sequor customers for unauthorized trading and investments.

So-called purchase accounting may have muffled these aftershocks. This bookkeeping method -- unusual in a stock-swap merger -- allows any loss recognized within a year of the acquisition to go on the balance sheet as goodwill and be written off over 25 years rather than as one-time, stock-rattling earnings hits.

But the accounting practice has its costs. It confuses some investors. Also, the goodwill charges, plus other recurring merger-related write-offs, amount to $130 million a quarter, canceling more than half the cost savings realized. Furthermore, goodwill must be subtracted immediately from capital, which regulators require banks to maintain at certain levels as a cushion against losses.

And as more and more Security Pacific mistakes bubbled up, BankAmerica officials showed less and less respect toward their new colleagues.

One of the first to feel this lack of respect was Mr. Smith himself. As BankAmerica's president and chief operating officer, he shared a newly formed "office of the chairman" with Mr. Rosenberg and was supposedly a contender to succeed him eventually. But within two weeks after the merger closed, Mr. Smith found himself with nothing to do. What is more, people close to Mr. Smith say, Mr. Rosenberg soon told Mr. Smith that he would never get the top spot at BankAmerica because the bank's regulators blamed Mr. Smith for Security Pacific's deterioration.

Mr. Smith, his associates say, was stunned both by this assertion and by the fact Mr. Rosenberg apparently had neglected to speak up for him. Both decline to comment.

In June 1992, Mr. Smith said he would resign. He floated off with a $3 million golden parachute.

Although most takeovers involve some dismissals, Security Pacific officials say their deal hinged on a gentlemen's agreement to share power at the top. They note terms calling for a 50-50 board split and the naming of Security Pacific people to four of the top 10 managerial positions.

Yet almost immediately, Mr. Rosenberg and his top aides undercut this agreement, people from both banks say. Three of the top four

Security Pacific managers, including Mr. Smith, are gone. And the board is weighted two-to-one in favor of BankAmerica, partly because BankAmerica lowered the directors' retirement age after the deal was done.

Through a spokesman, Mr. Rosenberg declined to comment on the issue of a gentleman's agreement and referred a reporter to the bank's press release announcing the merger. Mr. Rosenberg also denied BankAmerica harbored any institutional bias toward Security Pacific. After the merger, the best person from either bank was selected for a given job, he said through the spokesman.

In the months following Mr. Smith's announced departure, dozens of Security Pacific executives were forced out or resigned in despair. Most insulting of all, the former managers say, was Michael Rossi, chief credit officer. Mr. Rossi is a fierce competitor, known to manhandle staffers on the basketball court, and a hard-nosed businessman.

At orientation sessions known as "Camp Rossi" to the 2,000 Security Pacific employees who attended, Mr. Rossi assailed their bank's lax policies and marginal borrowers. At one meeting, when no one responded to his call for questions, Mr. Rossi quipped, "What is this, a dumb group?" according to Chuck Livingstone, a former manager who attended. A story also circulates through the ranks of how, at another meeting, he asked everyone to wave their right hands in the air and explained, "The key to your success at BankAmerica is getting used to saying goodbye to Security Pacific customers."

Mr. Rossi denies making either statement. "I am confrontational," he says, "but I never had any intent to insult."

The animus felt by Security Pacific managers led to so many departures that now BankAmerica is recruiting to fill holes on its senior staff, which some analysts consider thin.

Other former Security Pacific employees say they haven't encountered hostility at BankAmerica. Frank Abraham, a senior credit manager, says, "I'm happy. I got significant new responsibilities and a promotional opportunity. I wouldn't be here if I felt I was blamed for Security Pacific's problems."

As BankAmerica slashed personnel costs, eliminating the equivalent of 10,000 full-time jobs, it was accused of trying to avoid paying severance by forcing abcut 20 Security Pacific personnel-department programmers to take temporary jobs at a consulting firm; it relented after a protest. The bank denies the proposed moves were a bid to skirt its obligations and says it generally pays severance in such cases.

In addition, branch employees in Washington state, on behalf of 344 colleagues, have alleged in a complaint filed in a Seattle federal court that BankAmerica breached its fiduciary duty in denying them severance when it sold their branches. The bank says the employees were guaranteed comparable jobs and benefits with their new employers in lieu of severance.

The various cutbacks caused morale to drop. Making matters worse, bank employees learned from newspaper reports that just 19% of all branch employees would retain full-time jobs and fully paid benefits. "Morale is nowhere near as good as we would like to see it. It's probably no better than fair," said Chief Financial Officer Lewis Coleman.

Many former Security employees still fume over the "merger-of-equals" talk. While it may have helped to prevent a mass exodus and disruption of business, they see it as dishonest. "In mergers, people have to be let go," says Stephen Carpenter, a former Security Pacific vice chairman and among the first to depart. "But many people felt they were lied to, and that makes the pain of

losing your career greater. I don't know how those folks shave in the morning."

The turmoil has affected bank customers. U.S. Filter Corp. said it switched to First Interstate Bancorp after BankAmerica refused to accept Security Pacific's paperwork, thereby causing months of delay in securing a credit line. The Men's Wearhouse turned to NationsBank partly because it had qualms about BankAmerica's customer service. And the Software Supermarket said it switched after BankAmerica canceled overdraft protection, charged excessive fees and called a loan without explanation.

Though declining to discuss specific customers, BankAmerica says its retention of Security Pacific customers, at 96%, exceeds expectations. It has been helped by an unpublicized policy of paying $100 on the spot to appease disgruntled customers -- some of whom have cashed in at several branches.

With Security Pacific now largely digested, BankAmerica's most pressing challenge is to reverse a slump in revenues. The bank says it intends to accomplish this by giving loan officers more latitude and getting more business from each customer. "Our share of the customer wallet is about half what it used to be, and we have to fundamentally reverse that decline," says Mr. Coleman, Mr. Rosenberg's likely successor. That means taking back ground ceded to securities firms, consumer finance companies, mortgage banks and others.

Mr. Rosenberg thinks the Security Pacific purchase gives BankAmerica a critical mass of consumers that will throw off huge revenues. Does he have any regrets about his hasty bargain? Mr. Rosenberg laughs. "That's a really good question. I never thought about it in those terms. . . . But certainly there is no buyer's remorse," he says, laughing again. "No, oh no."

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Corrections & Amplifications

THOMAS HANLEY, an analyst with First Boston Corp., was quoted incompletely in a page-one article yesterday that said he felt "disappointment" about BankAmerica's merger with Security Pacific Corp. Mr. Hanley said he feels "mild disappointment" about the merger.

(WSJ July 23, 1993)

## PREPARED TESTIMONY OF DAVID B. MALKIN, CLU, ChFC

### Member, Board of Trustees, National Association of Life Underwriters

Mr. Chairman, and Members of the Committee. Thank you for the opportunity to testify this morning. My name is David B. Malkin and I serve on the Board of Trustees of the National Association of Life Underwriters (NALU), a federation of State and local associations whose members include the vast majority of professional life and health insurance agents throughout the Nation.

I appear today on behalf of the more than 500,000 insurance agents and their employees represented by NALU and the other national insurance agent trade associations: the Council of Insurance Agents and Brokers, National Association of Professional Insurance Agents, Independent Insurance Agents of America, American Land Title Association, and National Association of Surety Bond Producers.

I am accompanied today by Ann Kappler, counsel to our alliance, who will be able to answer any technical questions you may have.

### Introduction

You have asked us to appear today to discuss the prospect of legislation concerning banks' sale of insurance. This issue is certainly not new to us, to the other members of this panel—or to this Committee. You have heard much from us in the last few years on the question of banks and insurance. Our alliance has appeared before Congress numerous times advocating continued separation of the two industries, and clarification of that separation by Congress. Most recently, the Senate addressed these issues in S. 543—legislation which you have specifically asked us to address today.

Little has changed since this Committee and the full Senate passed S. 543. The regulators, in particular, the Comptroller of the Currency, continue to promote expanded bank powers to engage in non-banking activities, especially insurance-agency activities. We continue to challenge in the courts the regulators' improper usurpation of Congressional authority. The courts have clearly grown weary of the battle. In the two most recent court of appeals decisions, the courts explicitly directed the parties to bring the issues before Congress, affirming that Congress—not the regulators and not the courts—must resolve the policy issues involved. We could not agree more. And the time for Congress to act is now.

Several issues have recently been resolved. The Supreme Court has settled the question whether Section 92 of the National Bank Act—the so-called "small town exemption"—continues to exist.[1] There had been a lingering question as to whether the provision, enacted in 1916, had been inadvertently repealed in 1918. The D.C. Circuit ruled that there was such repeal and that the provision no longer exists. The Supreme Court unanimously reversed in a decision issued earlier this year.[2] So, as things stand today, Section 92 remains on the books.

And in a remand of that same case, the D.C. Circuit upheld the Comptroller's interpretation of Section 92 as permitting national banks to use small town offices as a launching pad for nationwide sales of insurance.[3]

But not all court decisions have favored the Comptroller's activist interpretation of national bank powers. The Second Circuit ruled that the "incidental powers" clause of the National Bank Act does not permit national banks to sell title insurance; any such sales must be confined to the banks' small town offices under Section 92.[4] The Supreme Court declined the Comptroller's request to review that decision.[5] And, most recently, the Fifth Circuit similarly ruled that the "incidental powers" clause does not permit national banks to sell annuities outside small towns.[6]

It is against this backdrop that this Committee again considers banks' insurance-agency powers.

We are here today to endorse the principles ensconced in S. 543. We are not asking this Committee or the Congress to reinvent the wheel. These issues have been fully considered, at length, in the past. The Senate, in particular, has worked out the important policy issues implicated by banks' sale of insurance. We are simply urging you to reaffirm your prior commitment to the continued separation of bank-

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[1] Formerly codified at 12 U.S.C. §92.

[2] *United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 113 S. Ct. 2173 (1993).

[3] *Independent Insurance Agents of America, Inc. v. Ludwig*, 997 F.2d 958 (D.C. Cir. 1993).

[4] *American Land Title Ass'n v. Clarke*, 968 F.2d 150 (2d Cir. 1992).

[5] *Chase Manhattan Bank, N.A. v. American Land Title Ass'n*, 113 S.Ct. 2959 (1993).

[6] *Variable Annuity Life Insurance Co. v. Clarke*, No. 92–2010 (5th Cir. 1993).

ing and insurance. We are asking you to reaffirm S. 543, with several modifications that will strengthen the protections it affords.

Specifically, we urge Congress to take four steps, all of which were included as part of S. 543: *First,* to close the Section 92 loophole created by the Comptroller that permits nationwide sale of insurance by national banks located in small towns. *Second,* to make clear that Congress, and not the Comptroller, has the authority to legislate on bank insurance powers. *Third,* to implement consumer protections applicable to all federally insured financial institutions selling insurance. *Fourth,* to close the "Delaware loophole" that permits States to authorize their State-chartered banks to export their insurance activities to other States, even to States that do not permit their own banks to engage in the insurance business.

Before addressing those specific provisions of S. 543, however, I would first like to explain briefly the basic principles that animate our proposals.

## Reasons to Separate the Banking and Insurance Industries

Ms. Korczyk, a renowned economist who has studied these issues for many years and has testified about the importance of separating banking and insurance in many fora, has already spoken cogently to these issues, so I will address them only briefly.

Put simply, our position is this: The sale of insurance by banks is inherently unfair both to consumers and to insurance agents not affiliated with banking institutions. The reason is simple: When a bank simultaneously loans money and sells insurance, a borrower faces an inherently unfair circumstance. Especially in hard economic times, when credit is tight, what borrower will fail to buy insurance if there is *any* possibility that the purchase might improve the chance for a loan? Especially in small towns and limited markets for credit, what insurance agency will feel comfortable when it needs money and has to borrow it from a bank that is also its largest competitor? The risks of harm clearly outweigh the putative benefits of full-fledged bank entry into the insurance business.

To begin, the notion that consumers will necessarily benefit from bank sales of insurance must be dispelled. It is important to keep in mind that insurance customers shop on the basis of coverage, price, and customer service. No seller of insurance—including banks—can have any control over the scope of coverage. The availability of insurance is controlled exclusively by each insurance company, which decides what type of business it wishes to write, what limitations it wishes to place on the coverage it offers, and what exposures it wants to insure. Thus, the sale of insurance by banks would not create a greater supply of liability insurance for small businesses, nor would it increase the number of available homeowners' policies.

Nor is there any evidence that banks' entry into the market will lower the cost of insurance to the consumer. To the contrary, there is substantial evidence that banks would charge more, not less, for insurance products. Credit insurance—the type of insurance in which banks have been engaged most prevalently—is the most dramatic case in point. Banks have consistently been shown to sell credit insurance at the highest possible rate. In fact, in 1990, the Consumer Federal of America conducted a study in which it found credit life insurance, sold almost exclusively by lenders, to be "the Nation's worst insurance ripoff." To the extent the bank has realized any cost savings, those savings are not passed on to the consumer.

The third aspect of insurance sales—service—similarly offers no evidence of bank advantage. Even if one were to give credence to the supposed benefit of "one-stop-shopping," the purchase of insurance is only the beginning of the services provided by an insurance seller. Of equal or greater importance is claims service: the ability of insurance agents to respond when disaster strikes, to meet the customer's needs when the customer's needs call for attention. An insurance agent does not work bankers' hours.

By contrast to the paucity of evidence of potential benefits, bank entry into the insurance business poses very real risks to fair competition and to consumers. I would like to focus on one particular aspect of these risks the danger of express and implied consumer coercion by bankers who also sell insurance.

Banks, especially banks outside large cities, exercise significant market power. Particularly in times of economic downturn, access to credit is not easily available. A recent study by the Federal Reserve Board demonstrated that "[o]verwhelmingly, the single most important financial institution for nearly every financial product

and service used by small- and medium-sized businesses is a local commercial bank."[7]

But the ability of banks to tie insurance products to its financial products does not depend on market power. In the banking industry, the power to affect a customer's decision is inherent in the banking relationship itself. That is, no small business dependent on a loan or line of credit, is going to challenge a bank that, as part of its loan approval or review process, "suggests" that the borrower purchase insurance from the bank, even if the customer understands he or she has a theoretical right to shop around for credit.

The coercion need not be express; the tie-in need not be compelled. Indeed, the greatest danger is of voluntary tie-ins—customers restricting their ability to shop for insurance products. "Voluntary" tie-ins are "inherent" in the combination of the sale of any product and the extension of credit. People think that they will enhance the likelihood that they are going to get the credit by buying this product.[8]

The pervasive existence of "voluntary" tie-ins explains why simple legal restrictions, like the anti-tying statute found in the Bank Holding Company Act, 12 U.S.C. § 1972, fails to achieve the abolition of tying arrangements.

Quite apart from the fact that banks have preferential access to cheap funds by which to enter the insurance business, and that the existence of Federal deposit insurance gives banks a special means of getting customers in the door, the potential—indeed, the existence—of tie-ins creates a grossly unlevel playing field. It is Congress' responsibility to maintain fair competition. Such balance is best for all the market players and for the consumer. If permitted to sell insurance, banks would be given competitive advantages over the insurance agent who is not affiliated with a bank. Not only the agent, but also the consumer is the loser.

The bottom line is that banks should not be permitted to sell insurance, or only in *very limited* circumstances. Congress has traditionally and consistently agreed with this policy judgment. Thus, both the National Bank Act and the Bank Holding Company Act bar the general sale of insurance by banking organizations. Unfortunately, Congress' judgment has not been respected by the Federal banking regulators, and courts have usually felt duty-bound to defer to agencies' actions. As a result, the regulators have chipped away at the protections enacted by Congress. It is time for Congress to act to correct this situation.

## Specific Legislative Protections Called For

### A. Close the Section 92 Loophole

Our first specific proposal is to close the giant loophole created by the previous-Comptroller Clarke in Section 92 of the National Bank Act. Before Section 92 was enacted in 1916, it was universally understood (including by the regulators) that national banks had no authority whatsoever to engage in the sale of insurance.[9] The Comptroller at the time proposed Section 92 as a means of enabling national banks located in small towns (5,000 or less) to earn additional income and compete with State-chartered banks in those States where they were permitted to sell insurance. He made clear in proposing Section 92, however, that it was not his intent to create bank department stores, to permit sales in larger locations, or to interfere with those entities who concentrated in the insurance-agency business.[10] Section 92 was enacted on these terms—as a very limited exception to the general prohibition on national banks' sale of insurance.

For over 70 years, no one ever dreamed that the small-town exemption permitted national banks to sell insurance anywhere but in the small towns in which they were located. But, in the mid-1980's, Comptroller Clarke changed that view. Comptroller Clarke, for the first time, opined that Section 92 permits a national bank to sell insurance from its small town office to customers located anywhere. Through the simple expedient of opening a branch office in a small town, a national bank could engage in nationwide insurance sales. The regulator thus converted Congress' intention of providing some assistance to small town banks into a means by which

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[7] G. Elliehausen & J. Wolken, Banking Markets and the Use of Financial Services by Small- and Medium-Sized Businesses at 32 (Staff Studies, Bd. of Governors of the Federal Reserve System, September 1990).

[8] *THM, Ltd. v. Commissioner of Ins., et al.*, No. 104457 (Mich. Ct. App. May 1, 1989) (quoting Dr. Emmett Vaughan).

[9] *Saxon v. Georgia Ass'n of Independent Ins. Agents, Inc.*, 390 F.2d 1010, 1013 (5th Cir. 1968); 53 Cong. Rec. 11001 (1916) (comments of then-Comptroller Williams in proposing Section 92); 2 Fed. Res. Bull. 73, 74 (1916).

[10] 53 Cong. Rec. 11001 (1916).

national banks could enter an entirely new line of business.[11] He essentially eviscerated the limitations so carefully drawn by Congress when it enacted Section 92.

We whole-heartedly embrace the provision of S. 543 that would close this loophole. Namely, the present version of Section 92 should be repealed and replaced with a new, clearer statement of congressional policy.

National banks with offices, branches, or subsidiaries, in small towns—that is, towns with populations not exceeding 5,000—would continue to be permitted to sell general insurance. But those sales activities must be confined to the small town and its immediate rural environs. Moreover, it must be made clear that the intended customer is the small-town resident, business or property-owner.

In addition, to the extent national banks are permitted to sell title insurance in small towns, they should not be permitted to engage in such activities in connection with their own mortgage loans.[12] Any contrary policy would create significant conflicts of interest, pose safety and soundness concerns for the banks and purchaser of loans on the secondary mortgage market, and produce consumer and competitive problems.

Homebuyers and other real estate purchasers buy title insurance for financial protection against unknown liens and claims against their ownership interest. Mortgage lenders, such as national banks, require title insurance to protect the validity, priority, and enforceability of their mortgage liens. A bank, as prospective insured, has an interest in obtaining the broadest possible policy coverage, while in its function as a title insurance agent has fiduciary responsibilities to the title insurer to minimize exposure to undue risks. This conflict of interest is particularly evident when a bank acts as agent for the issuance of title insurance on its own mortgage loans, which it usually expects to sell in the secondary mortgage market.[13]

Unlike agents in other lines of insurance, title insurance agents make substantive determinations in connection with the issuance of the policy—the search and examination of title, and the determination of what existing liens or claims must be excepted from the policy's coverage—and are liable to the insurer for negligent performance of these duties. Thus, the bank has far greater exposure than sellers of other types of insurance, especially with regard to title insurance in connection with its own mortgage loans, where the protections of *independent* judgment are jeopardized.[14]

The risk to the consumer is obvious. In 1977, the Justice Department concluded that if professionals in real estate transactions, such as mortgage lenders, can refer title insurance business to captive agencies, "the purchaser is likely to end up (1) paying unreasonably high premiums, (2) accepting unusually poor service, or (3) accepting faulty title examinations and policies from the controlled title company."

The risk to competition stems from the fact that title insurance is a one-time purchase; there is no renewal business available. Where State chartered banks have been permitted to sell title insurance, they frequently capture over 90 percent of the business of the bank's borrowers; there is no competition. Indeed widespread entry of banks into the title insurance business poses the potential for elimination of independent agencies from the market.

### B. Clarify the Comptroller's Power to Create New Insurance-Agency Powers for National Banks

In our second proposal, we urge Congress to make clear that the Comptroller is not free to create new insurance powers for national banks in the guise of interpreting banks' "incidental powers." Section 24 of the National Bank Act grants national banks "all such incidental powers as shall be necessary to carry on the business of banking."[15] Over time, the Comptroller has more and more broadly interpreted this provision to permit national banks to sell insurance. First came credit-related insurance, then title insurance, most recently annuities.

Basically, we believe Congress should freeze the law where it is: to the extent national banks have been held to be permitted to engage in insurance sales pursuant

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[11] As noted earlier, one Federal court of appeals, the D.C. Circuit, has deferred to the Comptroller's interpretation of Section 92. *Independent Ins. Agents of Am. v. Ludwig,* 997 F.2d 958 (D.C. Cir. 1993). In so ruling, however, the court advised that the "'solution' . . . lies with Congress, not the courts."

[12] Senator Riegle himself emphasized the policy concerns about such activities during debate on S. 543. *See* 137 Cong. Rec. S17380 (Nov. 21, 1991).

[13] For an excellent discussion of the problems posed in this regard, see Prof. Joyce Palmer's article "Bank Control of Title Insurance Companies: Perils to the Public That Bank Regulators Have Ignored," 44 Southwestern Law Journal 905 (Fall 1990).

[14] "The Pricing and Marketing of Insurance," A Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities, January, 1977, at 273.

[15] 12 U.S.C. §24 (Seventh).

to the incidental powers clause—that is, if a court has finally decided that it is lawful—they may continue to do so. But as to any other insurance-agency activity, they are strictly confined to Section 92's small town exemption. Section 92 is the only source of insurance-agency powers for national banks.

Two Federal courts of appeals have held that the incidental powers clause does not authorize the Comptroller to create new insurance powers for national banks. The Second Circuit in New York ruled that the sale of title insurance is not an incidental power and must be confined to small towns pursuant to Section 92. Most recently, the Fifth Circuit ruled that the sale of annuities is not an incidental power and any sale of annuities by national banks must be confined to small towns.

We simply urge Congress to make clear what the courts have already held, but which the Comptroller apparently does not believe. Such an amendment would block the Comptroller's increasing appetite for insurance powers. No longer would the Comptroller be able to authorize expanded insurance activities for national banks, thus forcing litigation that results in the wasteful use of resources by both the government and the private sector.

C. Implement Meaningful Consumer Protections

Our third proposal emanates from the principle that the existence of Federal deposit insurance places a duty upon the Federal Government to ensure that bank-insurance activities, where permitted, do not result in abuse of customers. This is not a controversial position. In its initial proposal to Congress in 1991, the Treasury Department itself acknowledged the need to couple bank power reform with consumer protection. The Senate recognized this same Federal interest by adding consumer protections to S. 543. For title insurance, many of these protections are already incorporated into the Real Estate Settlement Procedures Act, with which we believe insured financial institutions should have to comply if they are to be permitted to sell title insurance.

We continue to support the approach that has been endorsed by Congress over the years, but we urge the adoption of more comprehensive protections than are included in S. 543. Let me give some more detail.

*First,* we believe that consumers must be affirmatively told that any insurance they purchase from an insured depository institution, or an entity affiliated with an insured institution, is *not* a deposit, is *not* insured by the FDIC, is *not* guaranteed by the insured depository institution, and is *not* otherwise an obligation of the institution.

*Second,* it is important that a bank's lending activities be strictly separated from its sale of insurance. We are not suggesting that a bank be prohibited from requiring the placement of insurance as a condition of a loan. But, in order to reduce the risk of tie-ins and consumer deception, it is critical that steps be taken to ensure that bank customers not be misled or confused by the fact that the financial institution is involved in both banking and insurance activities.

*Third,* we believe it is vital to control the timing of solicitation of insurance that is required by a loan agreement. An insured depository institution, or its affiliated insurance agency, should not be permitted to solicit insurance before the customer receives the written loan commitment. We also believe that the customer should have a fifteen-day "cooling off" period within which he or she may cancel the purchase of insurance from the bank-affiliated agency.

*Fourth,* banks must be required to affirmatively notify their customers that they are not required to use a bank-affiliated agent to purchase their insurance. And banks should be barred from unfairly favoring their insurance agents over other, unaffiliated insurance agents.

*Fifth,* the private financial data of customers must be protected. As a general matter, an insured depository institution, or its affiliate, should not be permitted to use nonpublic customer information for the purpose of soliciting the purchase of insurance. Access to and use of such formation not only tramples the customers' privacy interest, but also provides the bank-affiliated insurance agent with an unfair competitive advantage over other unaffiliated agents who have no access to such nonpublic information.

*Finally,* insured financial institutions must be required to comply with State laws governing the sale of insurance. It has always been recognized, by Congress as well as the courts, that the regulation of the insurance business is best left to the States. Thus, one would think it an non-controversial principle that banks should comply with State insurance laws in their insurance agency activities. But the Comptroller of the Currency has boldly stated that national banks need not abide by State law—indeed, they need not even be licensed by the State in which they operate. Congress simply cannot allow such unfettered and unresponsible deregulation. Not only is it patently unfair to those unaffiliated insurance agents who must comply with the

State laws, but it is also horrendously dangerous for the consumer. Licensing in particular is the one means by which insurance agents may be supervised and regulated.

The consumer provisions we describe are based on those that the National Association of Insurance Commissioners has adopted as model rules for the States, and on laws and regulations that several States have put in place. We note that in negotiations with a group of bank holding companies last year, the banks were willing to agree to the basic consumer protections we outline above. Our description here cannot, of course, include every detail of what we would offer. But, as a general outline, we hope that it explains how the interests of fair competition can successfully be included in the legislation that you are considering. We hope to have the opportunity to work with the Committee and its staff to discuss, in more detail, the kinds of consumer amendments that would make a difference.

### D. Close the "Delaware Loophole"

Our final proposal, at bottom, is a States' rights issue. One State should not be permitted to sanction insurance powers for its State-chartered banks and then authorize them to export those insurance activities to other States—including States that do not let their own State-chartered banks engage in such activities. Such a loophole currently exists in the Bank Holding Company Act. In 1990, Delaware enacted a law to take advantage of the loophole. The Delaware law permits bank holding companies to purchase a State-chartered bank in Delaware and to use that bank as the vehicle to both underwrite and sell insurance beyond Delaware's borders. We view such an extra-territorial attempt to interfere with the decision-making of another State as illegitimate. We believe each State should be allowed to decide for itself what kind of insurance activities will be permitted of bank-affiliated entities within its borders.

We understand that this is a controversial topic, especially for Delaware banks and legislators, and we are willing to work with you to find some reasonable accommodation of the various interests at stake.

## Comptroller's Statements Regarding National Banks' Sale of Insurance in "Distressed Areas"

On a final note, we would like to comment briefly on Comptroller Ludwig's recent endorsement of expanding the insurance-agency power of national banks yet again—this time, to permit them to sell insurance in "distressed areas," what we understand to be inner-city neighborhoods.

We cannot help but be suspicious of this proposal. The banking trade press has whole-heartedly embraced the notion, arguing that it will permit them to use an inner-city office as the base for nationwide sales of insurance. It is, after all, easier to locate one's insurance agency activities within the city in which you operate, rather than having to move it to "Smalls-ville, USA." We also must note that, if the banks' history as to banking services is any indication, the banks have no interest whatsoever in doing business in so-called distressed areas. There is no reason to believe that the ability to sell insurance in those areas will make either business—that is, either insurance sales or banking services—more attractive to banks in those locales.

Permitting national banks to sell insurance in the inner-city will not make insurance more available in those distressed areas. Agents do not underwrite insurance; insurance companies do. Making another group of entities eligible to sell the product will not give inner-city residents and businesses greater access to the product.

Moreover, we find this proposal remarkably out of step with Congress' current thinking. There are two separate bills currently in the House of Representatives which provide for Federal study of the problems associated with the provision of insurance in inner-city neighborhood. The studies are designed to discover whether there is a problem, what is its scope, and what is its cause. It is surely premature to assume that national banks' ability to sell insurance is going to be the saving grace of these neighborhoods. We believe it will have no impact whatsoever.

## Conclusion

We are very pleased that the Committee has taken up the issue of banks' ability to sell insurance. The time is ripe for Congress to act. As S. 543 reflects, most of the work has already been done. The hundreds of thousands of insurance agents across America that we represent stand ready to assist in achieving the goals the Senate has already embraced.

Thank you.

# INTERSTATE BANKING AND INSURANCE ACTIVITIES OF NATIONAL BANKS

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**WEDNESDAY, NOVEMBER 3, 1993**

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, DC.*

The committee met at 10:08 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

## OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The CHAIRMAN. The committee will come to order.

Let me welcome all those in attendance this morning and most especially our two very important witnesses who are here. We are meeting today to hear the views of the administration on nationwide banking and branching and on the insurance powers of national banks.

This hearing follows the October 5, 1993, hearing that the committee conducted on these very same issues. At that time, we heard from the Federal Reserve Board, the FDIC, and banking and insurance groups. Today, Under Secretary of the Treasury Newman and Comptroller of the Currency Ludwig will present the views of the administration. Then we will hear from the Conference of State Bank Supervisors, consumer groups, and representatives of State banking associations.

Last week, Secretary Bentsen identified inefficient restrictions on our financial system. And among the impediments he cited were restrictions on interstate banking.

We presently give States control over the geographic expansion of both national and State banks, whether that expansion takes place by acquisition or by branching.

In recent years, almost every State has permitted out-of-State bank holding companies to own banks in the State. But these State laws are not uniform and thus, restrictions still remain on nationwide banking. In addition, interstate branching is effectively prohibited.

Proponents of nationwide banking and branching argue that these restrictions result in costly inefficiencies and reduce competitiveness. They contend that consumers would benefit from increased competition and the convenience of being able to use bank branches in more than one State.

On the other side, there are those that warn that removing restrictions on nationwide banking could lead to an overly concentrated financial system. Those that take that view fear that

large, multistate banks would drain deposits from local communities. Community bankers are also concerned about what they view as unfair competition with large institutions coming into their area.

The 1991 legislation on nationwide banking passed by the Senate did permit bank holding companies to both acquire existing banks in any State and also to combine their bank subsidiaries in different States into a single main bank with branches.

Like interstate banking, the regulation of insurance has traditionally been handled at the State level. Many States have prohibited the banks they charter from selling insurance.

In 1916, Congress enacted a law allowing national banks located in towns of 5,000 people or less to be able to sell insurance. Seventy years later, the Comptroller of the Currency interpreted this provision to allow a bank branch in a town of 5,000 to sell insurance to any individual or business in the entire United States.

After 7 years of litigation, the District of Columbia Circuit recently held that the Comptroller's interpretation is "permissible." While that interpretation may be permissible as a matter of law, many in Congress believe it is not appropriate. The legislation passed by the Senate in 1991 clarified that a national bank in a town of 5,000 may sell insurance only to individuals and businesses in that town and certain surrounding rural areas.

At the same time, it placed national banks on the same competitive footing as State banks by allowing a national bank to sell insurance to the same extent as State banks in the State where it is located.

Unfortunately, the House of Representatives did not pass comprehensive banking legislation in 1991, as we were able to do here in this committee and in the Senate as a whole, and the interstate banking and insurance sales provisions of S. 543 that I've described were thus then not enacted into law. So we have sought the views of the administration on these matters and we've asked Mr. Newman and Mr. Ludwig to use the provisions passed by the Senate in 1991 as the starting point for their testimony today.

We look forward to hearing their views and the views of the others.

After today's hearing, we will work with the administration and others to prepare legislation on these matters for a committee mark-up on November 18, 1993. Meeting that November 18 date, however, will require the administration to give us more detailed views on the 1991 Senate-passed bill than it has presented in its testimony today. We will try to get some of those details nailed down as we go today.

Let me just say, before calling on colleagues, we're going to have a vote in the Senate, unless things change, at 11 a.m. on cloture. So I'd like to go ahead and get all of the opening statements out of the way and hopefully be able to get the statements of both of our witnesses in before that time. So I'd ask your help in that regard.

Senator D'Amato.

## OPENING COMMENTS OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Mr. Chairman, I'm going to ask that my full statement be placed in the record as if read in its entirety to save time.

The CHAIRMAN. Without objection.

Senator D'AMATO. I welcome our two distinguished panelists, Comptroller Ludwig and Under Secretary Newman. I believe that the time for interstate banking has long since passed. I am cosponsor of Senator Dodd's legislation. I think that's the way and the manner in which we should go. I think we should go about it aggressively and pursue this.

It does not make sense—here we're talking about free trade with Mexico, with Canada, and NAFTA, and we can't even have free banking within the confines of this country. You talk about ridiculous. It's ridiculous. It's costly. It's anticompetitive. It's anticonsumer. And we absolutely should tear those barriers down.

I've said enough. I have an Intelligence Committee being conducted right now, Mr. Chairman, so I will look forward to reviewing with you and others the testimony of our witnesses. I think the administration is moving in the right direction. I'd just like to see them do it a little more forcefully and I suggest that approach. However, I applaud you for being supportive of this move and I certainly will do everything I can to work with the administration, Senator Dodd, and other Members of this committee, to achieve this goal of full integrated banking throughout our country.

The CHAIRMAN. Thank you very much, Senator D'Amato.

Senator Dodd.

## OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you, Mr. Chairman. I'd just take a couple of minutes, if I can, and express my thanks to you, Mr. Chairman, for holding this hearing. You committed early on that this would be the case, that we'd get a hearing and we'd do our best to try to move a piece of legislation and I commend you for doing that in the midst of everything else that's going on.

Obviously, we only have a few days left if the leaders' projections are correct, in terms of legislative days. So my hope is that we can get something out of the committee before we adjourn for the holidays. But, nonetheless, I want to thank you and thank my colleagues here who have cosponsored the bill that I've introduced and welcome our panel of witnesses, including a good friend, Jerry Noonan, who is president of the Banks Association of Connecticut, who came down yesterday and went back yesterday and came back again today as a result of having to delay the hearing.

At any rate, since our last hearing, I'm pleased that the administration has outlined its position on interstate banking. In his recent speech delineating the administration's banking priorities, Secretary Bentsen expressed his support for interstate banking and branching as a means, and I quote him, "to eliminate roadblocks and make it less expensive and cumbersome for our banks to operate across State lines."

Under Secretary Newman and Comptroller Ludwig, who are here with us this morning, have since articulated in great detail, and I commend them for it, the reasons for the administration's support

for interstate banking, and we'll hear from them this morning as well.

I regret, and I would say this and have said this to them privately, that their conclusions thus far have not yet justified the strength of their support for full interstate banking, but I'm hopeful this morning that we can examine that particular question and that the administration's position will become clear and more consistent as we move ahead.

I believe that full interstate banking, Mr. Chairman, as you know, would streamline administration, improve bank efficiencies, ease regional economic slumps, boost consumer conveniences, ameliorate the impact of future credit crunches, and enhance the safety and soundness of the banking industry.

I've discussed many of these benefits of interstate banking and branching in much greater detail before, so I won't go into all of the reasons for my support this morning. I would, however, like to touch briefly on one area which is frequently underplayed, and that is the benefits to consumers.

Secretary Bentsen recently commented, and I quote him:

> In the age of fiber optics, when I can go to a machine on the streets of virtually any capital in the world and get cash with my bank card, not being able to make a deposit at my own bank just because that branch is in another State is like requiring that the space shuttle stay within the school zone speed limit.

For those who believe that the number of individuals who would benefit from these conveniences is small, recent statistics reveal otherwise.

The Census Bureau reports that 60 million Americans live in metropolitan areas that cross State lines. Four million Americans commute interstate each day—four million Americans cross State lines every day to go to work, and 493 million trips are taken by Americans each year across regions in this country.

In addition to increased convenience, consumers will benefit from the savings achieved through the breakdown of market barriers and through increased competition.

Recent studies have revealed that bank performance improves with increased market entry and lower prices, higher returns, and greater convenience results.

It's critical, Mr. Chairman, that we establish a sensible and consistent interstate banking and branching approach such as that outlined in S. 371, legislation which I've introduced with my colleagues, Senator D'Amato and Senator Kerry.

Our bill would permit bank holding companies to acquire, 1 year after enactment, existing banks anywhere in the United States. Eighteen months after enactment, a bank holding company operating subsidiaries across State lines could consolidate them into a single bank. Three years after enactment, banks would be able to branch interstate nationwide. States could opt out of branching if they choose, but banks that located in States that opt out would not be permitted to branch interstate, by the way, as well.

Our bill would promote efficiency and competition, while providing safeguards against bank concentration. It would protect safety and soundness and prohibit undercapitalized institutions from participating in interstate branching. It would respect the interests of States by requiring branches to abide by all applicable State laws,

including consumer protection and fair lending. And it would meet community needs by maintaining Community Reinvestment Act requirements.

At our last meeting, Mr. Chairman, I encouraged the banking industry and the insurance community to work together to reach a mutually beneficial agreement on interstate and insurance issues. I'm sad to report that that effort has not produced the kind of results I would hope, but hope springs eternal, I guess, and we'll continue to try to work here to see if something can't be done.

I would say, Mr. Chairman, however, this morning that I intend to offer an insurance amendment at the Banking Committee's mark-up on November 18, if, in fact, we're able to have a mark-up on that date.

This committee and the Senate have dealt with interstate and insurance issues in the past. We've had trouble in resolving these issues, but the concerns are not going to go away.

The amendment that I'll offer, I'll just briefly say, Mr. Chairman, will be reasonable. It will include consumer protections. It will clarify Congress' intent on the towns of 5,000 issue. And it will prohibit the wholesale creation of new powers by the Office of the Comptroller.

It will not, however, include provisions closing the Delaware loophole, which were previously approved by this committee and by the full Senate only 2 years ago. Without Congressional action, the regulators and the courts, in my view, have made major policy decisions in bank and insurance areas by expanding loopholes far beyond their original scope and intent.

Even if you agree with the results of these policies, I think all of our colleagues, at least I hope, would believe that it doesn't make much sense to accomplish them in such a manner.

In its decision early this year, the D.C. Circuit Court invited the Congress, in fact, to clarify the Towns of 5,000 issue, stating, and I quote them:

> When time and technology open up a loophole, it is up to Congress to decide whether it should be plugged and how.

I believe that is our responsibility, Mr. Chairman, and we'll have a chance to consider that when the mark-up occurs. But, again, I want to thank you for holding the hearing. I apologize for taking a few minutes in the statement, but I spent a lot of time on this issue over the years and I feel like Sisyphus with this issue. We roll this rock around and get it, every now and then, just to a point and it rolls back down on us.

I'm looking for a formula that will allow us to get this accomplished and also take into consideration the concerns of our colleagues in the other chamber. And part of the interest in the insurance issue, in no small measure, springs from that concern as well, that before your tenure is up, Mr. Chairman, we're going to accomplish something we talked about for a long time, and that is to have a good interstate banking proposal, along with the other measures that I've mentioned.

So I thank you.

The CHAIRMAN. Thank you very much, Senator Dodd.

Senator Mack.

## OPENING STATEMENT OF SENATOR CONNIE MACK

Senator MACK. Thank you, Mr. Chairman. Again, thank you for holding this hearing. I generally support what has been said this morning and I think that 2 years ago, I was supportive of the efforts that we made to expand bank powers.

However, I must say to you that there are some reservations that are beginning to creep in and it probably has to do with what I sense has been going on within my own State and I have a feeling probably in other States as well. I don't have the specific numbers, but roughly four large banking institutions in my State control roughly 75 percent of the deposits.

The thought that keeps going through my mind is that, as, again, most of us have experienced over the last several years, hearing from our constituents about the difficulty of obtaining credit, my concern is that with a system where, in essence, there are fewer and fewer individuals making the decisions about where to lend, what types of loans are going to be made, and the conditions under which those loans are going to be made, is a little bit unnerving to me.

For some reason, I'm much more comfortable with the thought that there might be 400 or 500 different bank presidents out there trying to decide, in their local community, what the best loan policy is, in fact, to put into place.

And the other thing, I remember that during those days, the discussions that I had with many bankers around the State, in essence, they would say to me, a lot of what is happening here, with respect to real estate, is out of our hands because we have a primary concern as to what happens to the value of our stock, and naturally, they should if they're going to be protecting the interest of their stockholder. If the banking stock analysts around the country are going to be saying that if a certain percentage of the loan portfolio is made up of real estate loans, they devalue or discount the value of that stock, all of a sudden, decisions are made not to lend on real estate in that community, not because the banker thought it was bad in that particular community, but because of the concern about what would happen to the value of the stock.

I generally think that the advantages that are derived as a result of interstate banking are well stated. In fact, we probably are at a point where it's not a question whether we're going to have interstate banking; it's whether we're going to do it efficiently.

I just want all of us, as we go through these discussions and try to work up a piece of legislation, to keep in mind the effect that this could have on local communities and the availability of credit.

Now, the last point that I would make is that, as I observed what happened in my local community as a result of going from a relatively large number of individually owned and operated banks to where we are today, there are fewer managers of those banks that really have direct ties to the local community, that grew up in the local community.

This is not just a question of whether they know the customer or not. It's really whether they're a part of the fabric of the community, whether they're really willing or able to make the commitment to the local community of the kinds of loans that should be made.

I know, again in our own experience, that we ended up making loans in the community because we felt it was in the best interest of the community. I'm not sure that you get that same kind of input from a career banker who is on his way up through the branches to a bigger and more significant position within the institution.

The last point I would make, and it's along that same line with respect to competition, I think it is becoming more and more difficult for the small community bank to be profitable given the level of regulation that they have to deal with.

I would hope that as we work through this legislation, that we would try to provide some kind of balance here in reducing some of the burden. I'm thinking particularly of CRA.

The proposal that I had talked about a couple of years ago, would exempt institutions under $100 million from CRA. The people who are for the Community Reinvestment Act, I think with a very, very narrow vision, oppose any kind of suggestion about any modification to CRA from reducing the number of institutions that are affected.

However, I want to point out, if you drew a line at $100 million in deposits or in assets in my community, still 87 percent of the deposits would still be covered by CRA. But it would relieve some of the smaller banks from what I think is just a growing level of regulation and an increasing burden on the small community bank.

So those are some of the thoughts I have. Again, I'm generally supportive, but I just wanted to say to folks, those are a couple of areas that I'm going to be keeping an eye out on and have a great deal of interest in.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Faircloth.

## OPENING STATEMENT OF SENATOR LAUCH FAIRCLOTH

Senator FAIRCLOTH. Thank you, Mr. Chairman.

I would welcome our witnesses, Mr. Ludwig particularly. He came by. We had a nice visit a few days ago, and discussed very much of what we're talking about here this morning.

We certainly live in a world of worldwide capital markets, if not any other worldwide market. Money moves easily all over the world. We are competing for money all over the world. So, for that reason, we cannot and should not unduly regulate banks and artificially restrict what they do.

It does neither the customer nor the capital going to the U.S. banks any good if we unduly restrict their operations. It simply goes to foreign competitors. We need to do anything we can to give our banks more ability to compete.

Banks hold a special position in the financial service industry, just by the fact that the deposits are insured by the taxpayers. So we need to be careful how we allow them to expand, and as mentioned, we need to keep some control but we have got to relieve the inability to interstate banking. In fact, Mr. Chairman, I came here this morning and I was 100 percent for interstate banking. And then I heard Senator Dodd and I had to rethink my position.

[Laughter.]

Senator DODD. And it makes me rethink mine, too.

[Laughter.]

Senator FAIRCLOTH. I think it's past time to implement interstate banking. It would remove a mountain of regulations even off of the smaller banks. But I have a feeling that banks should stick to banking. I am not as convinced on allowing banks into the insurance business. I am not committed to that thesis yet. As far as interstate banking, I'm 100 percent for it and I think we should get on with it.

Thank you.

The CHAIRMAN. Thank you very much.

Senator Roth.

## OPENING STATEMENT OF SENATOR WILLIAM V. ROTH, JR.

Senator ROTH. Well, thank you, Mr. Chairman.

Let me begin by saying that I share the views recently expressed by Secretary Bentsen—that permitting a true interstate banking system can lead to a safer and stronger banking system, increased lending, and will ultimately benefit the consumer.

But while I generally support efforts to remove or loosen what I consider to be outmoded restrictions on banks, I do have concerns that I have not heard acknowledged by either proponents or opponents of interstate banking and branching. In particular, I am troubled as to just how the proposals would work, or not work, in our Federal system.

I wonder how, for example, once banks are converted into branches, the parent bank will be able to export the interest rates of the home State into the branch's State. If it cannot, many credit card operations will be upset by the legislation.

As it stands now, certain provisions of the legislation relating to consumer protection and fair lending would subject an out-of-State branch to the laws of the host State and could be construed as prohibiting exportability under such circumstances. The committee has received a letter from the FDIC to that effect. Now, I don't believe that this is the intent of the legislation, but it could be its effect. At a minimum, we need to clarify these provisions.

Another concern that I have with this legislation is its potential impact on State tax revenues. I wonder whether the legislation is truly revenue-neutral with respect to the tax revenues of each individual State.

If, for example, a State like Kentucky taxes the corporate status of the banks in that State, and those banks lose the status when they are converted into branches, does that affect Kentucky's revenues? Will States that host a branch be able to lay greater claim to tax the income of a present bank on the basis that the parent "exists" in the host State through its branch? If so, this could trouble the very institutions that hope to gain under the legislation.

In short, I remain concerned over the very substantial adverse impact on State tax revenues this legislation may have. States will be affected, and banks will be affected. I know of no bank that wants to be taxed on 150 percent of its income. Well, unless the tax issue is resolved prior to enactment of this legislation, I suggest that many banks may be in for a surprise.

In 1991, I raised this issue. Since that time, States, banks, and the multistate tax commission have been working to establish new tax rules that fairly accommodate often competing interests. It's my understanding that the draft rules will be available next year for review and comment. It would be a mistake, in my opinion, for this committee to go forward to mark-up interstate branching legislation this month without an appreciation of how the new banking rules fit with the new tax rules.

Moreover, the new administration has not yet finalized its views on the details of the legislation and appears to me not anxious to proceed on this legislation, at least this year. So we should take the hint.

Finally, it would seem to me that the chances for enacting interstate branching would be substantially enhanced if its major proponents would delete rather than support unrelated provisions which are opposed by both the banks and the administration. Why is that approach unthinkable?

Mr. Chairman, I look forward to the testimony of the witnesses and invite their comments in response to my concerns.

May I also ask, since I have another committee with which I need to attend, that we be able to supply written questions to the witnesses?

The CHAIRMAN. Of course.

Senator ROTH. Thank you, Mr. Chairman.

The CHAIRMAN. Secretary Newman, we're going to start with you. We're delighted to have you today. We'll have your statement and then we'll follow with Comptroller Ludwig.

## STATEMENT OF FRANK N. NEWMAN, UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. NEWMAN. Thank you, Mr. Chairman.

I'd like to start, if I might, by noting that this is the first time that I've testified here since you announced your retirement. I'd like to take this opportunity to commend you very genuinely for your leadership during this period of time, during the years that you've been Chairman of the committee.

You started early with that leadership by getting FIRREA through the Senate on a very strong bipartisan vote, just 2 months after the administration sent up the bill. This accomplishment had special meaning because I think it was a crucial demonstration of congressional resolve to begin to deal with the thrift problems that the Nation was facing.

In 1990, you introduced comprehensive deposit insurance reform legislation that contained such landmark reforms as prompt corrective action and least cost resolution, reforms that ultimately were enacted in the FDIC Improvement Act of 1991. These reforms have left our financial system safer, sounder, and stronger.

Under your leadership, this committee has also been active and productive in a wide range of other areas, from housing to securities market reforms, fair lending enforcement, and the Government-sponsored enterprises.

I think you can take just pride in a strong record of accomplishment and we, the administration, look forward to working with you the remainder of this year and next year.

The CHAIRMAN. Thank you very much.

Mr. NEWMAN. It's interesting, Mr. Chairman. Those of us who have not spent all that much time in Washington try to learn things. One of the things that I think we have very little appreciation for, until we come to Washington, is what it takes to be the chairman successfully.

The CHAIRMAN. A lot of good Members. That's the key. A great team.

Mr. NEWMAN. Again, congratulations.

Turning to today's topic, Mr. Chairman, Senator D'Amato, Members of the committee, I'm genuinely pleased to be here in response to your request to discuss the administration's views on interstate banking and bank insurance activities, two topics which we believe are conceptually distinct and should be dealt with separately.

I'm not here today to call for precipitous action in either area. As Secretary Bentsen declared last week, this administration will take a deliberate, disciplined approach that we think will produce more and better results over time. We will focus on achievable goals and pick targets carefully. We will build consensus issue by issue. And we will listen seriously to the concerns of all those with a genuine public policy interest in an issue.

The Secretary called for quick action on three bills already before Congress. These bills involve RTC funding, community development financial institutions, and fair trade and financial services, all bills, I should note, that this committee has acted on expeditiously.

U.S. geographic restrictions are unique among industrialized nations of the world. Many observers consider them among the least defensible of our banking laws.

I participated just a couple of weeks ago in a Brookings Institution conference. There were people there representing 16 different countries from around the world. At one point, I asked just for a show of hands, for anybody who came from a country where there were geographic restrictions on banks within their country. One person raised his hand. I said, what country are you from? And he said, the United States.

The administration clearly supports the idea of reducing these restrictions. In my testimony today, I will discuss the reasons behind our thinking, analyze the concerns most commonly raised, and provide the administration's views on key issues.

We find the current framework of geographic restrictions no longer appropriate for several reasons. First, modern banks operate beyond local markets and they compete with nonbank institutions that face no similar geographic restrictions. Second, the States themselves have relaxed geographic barriers. Third, removing these restrictions could improve the safety and soundness of the banking system. Fourth, the public could benefit from greater competition, improved bank performance, and greater customer convenience, as Senator Dodd just referred to and Secretary Bentsen noted earlier. And finally, removing geographic restrictions would let banks structure themselves more efficiently, which could ulti-

mately permit banks to make more credit available to businesses and individuals.

Banking organizations can no longer be defined in terms of the limited services and facilities considered appropriate in past generations. We now have banks funding themselves not only with local retail deposits, but with certificates of deposit, foreign deposits, Eurodollar borrowings, all forms of transactions that spread far beyond local markets.

On the asset side, banks have, for many years, reached for business opportunities beyond local markets. Real estate loans, commercial loans, foreign government loans, securitized loans, and various types of loan participations typically require involvement in nonlocal markets and groups of banks getting together.

Many nonbank financial institutions offer products that compete directly with bank services. Yet, these nonbanks can operate more efficiently partly because they face no geographic restrictions. And in fact, there have been many studies that have shown that the banks' share of market, measured in many different ways, has been declining virtually every year for the past, at least 10 years, partly because these other forms of financial intermediaries have been growing and growing with less burdens to deal with.

On balance, geographic restrictions have outlived their usefulness and no longer reflect bank practice or competition. Rather, they require banks to organize themselves in cumbersome and inefficient ways to compete.

Skipping here in the interest of time, Mr. Chairman, as you noted.

Today, 46 States plus the District of Columbia permit Statewide branching. Four States continue with limited branching and no State retains unit banking, the old policy of allowing banks to have only one office.

Currently, all States but Hawaii, and Hawaii under special circumstances, allow out-of-State bank holding companies to acquire banks within the State. There are now more than 40 States that have banks headquartered in those States that do business in more than one State, that have subsidiaries in more than one State.

Relaxing geographic restrictions will also tend to promote a safer and sounder banking system, and Comptroller Ludwig will comment on this more specifically. But geographic diversification helps, and reduction in operating expense helps.

We are convinced that many banks can realize very substantial efficiencies in their operations. It doesn't mean that necessarily every bank will realize efficiencies. Obviously, it's going to depend on the way they organize, and the effectiveness of their management. But many banks should realize very significant efficiencies simply from consolidating operations in multiple States.

A number of concerns are commonly raised about geographic liberalization. Included among these are concerns that liberalization might lead to a decline in the number of small banks, might result in an excessive concentration of resources, might siphon credit from local communities, and might damage the dual banking system. I'd like to briefly discuss each of these concerns in turn.

Among the most frequently voiced concerns is that interstate branching will inevitably reduce the number of small banks. How-

ever, ample evidence indicates that this outcome is not inevitable or even likely.

For example, small banks have continued to prosper in such States as New York, that has, over the years, significantly reduced intra- and interstate geographic restrictions. Even in States that have long had liberal branching laws, small banks prosper and compete successfully with large banks.

For example, in my home State of California, which has had unrestricted branching since the early 1900's, there are literally hundreds of small banks, as well as numerous thrifts and credit unions, that operate alongside large banking organizations with far-reaching branch networks.

Senator Mack commented that you would like to see hundreds of bank presidents. In California, despite the fact that there are a number of large banks, there are literally hundreds of small bank presidents and they, by and large, do quite well. The small banks do, with the recent exception of some banks in southern California, where their portfolios are not geographically diversified and the economic problems in southern California have been a problem for them, quite well also.

Thus, we believe that fears that relaxing geographic restrictions will undermine the viability of small banks and the maintenance of competition are not necessarily the case.

Over the years, small banks have been among the most profitable and best capitalized banks in the Nation. Well-managed small banks that know and meet their customers' needs, we believe, can continue to flourish without maintaining geographic barriers to entry.

One other consideration here is that, to the extent that we concentrate on consolidation, rather than at this point in time, addressing de novo branching on an interstate basis, we minimize any issues that fall along that line.

A longstanding concern about removing geographic restrictions involves the potential concentration of banking resources and its effect on competition. While this concern cannot be dismissed lightly, we believe that new measures to limit concentration are unnecessary.

Despite progressive consolidation at the State and national levels, the level of concentration in local urban and rural markets has remained virtually unchanged for almost two decades. I believe that a recently issued GAO report comes to the same conclusion.

As I discussed earlier, modern banks engage in a wide variety of activities in competition with a wide variety of nonbank financial intermediaries. Because of this, determining the appropriate limits on market share, or even the proper definition of the market, can be extremely complicated.

For example, savers now can place their funds in banks, in thrifts, in credit unions and mutual funds, and in other entities, including money market funds, that have check-writing capabilities.

So if one wants to measure market share, one can't simply look at the market share of commercial banks. You really ought to look at the market share of commercial banks plus thrifts plus credit unions plus money market funds if you want to look at the saver's side.

To look at market share on the asset side, one needs to look not only at banks and thrifts, but at commercial finance companies, consumer finance companies, and leasing companies.

There's just a wide variety of providers of financial services on both the savings side and the lending side that need to be taken into account when looking at market share.

For these reasons, we believe it is better to continue to rely on detailed reviews of specific merger and acquisition transactions by the appropriate Federal banking agencies and the Department of Justice, which is currently the practice, in order to assure competitive markets. In addition, as S. 543 recognized, there is no change in market share involved with simple consolidation of banks into branches.

Another concern raised is that interstate branching may undermine the intent of the Community Reinvestment Act of 1977, and siphon funds from local communities. But interstate branching legislation need not alter the CRA. All existing requirements of community reinvestment will remain intact and serve to ensure that banks meet local credit obligations.

Again, Comptroller Ludwig, who has been very much involved in this, will have further comments on it.

Moreover, we find no firm foundation for asserting that branch banking is more likely than other banking structures to divert funds from local communities. Indeed, the propensity to export capital or lend locally is unrelated to bank branching structure.

For example, a community bank, not wishing to lend locally or not finding sufficient local loan demand, can already sell Fed funds upstream to a correspondent bank, buy securities, or participate in loans originated by banks elsewhere.

Finally, the siphoning issue can work both ways. A bank can also inject credit into an area and bring funds into local communities. This is among the reasons why States have liberalized their branching and interstate branching laws. That is, broader geographic expansion authority can produce more efficient credit distribution, including a greater flow of funds to communities with the greatest credit demand.

I think New England is a very good example of this, a situation where the whole region had severe economic problems. The opportunity for banking institutions from other parts of the country, who had more geographically diversified portfolios, to bring capital into New England might have been an extremely helpful process at that time.

Another concern that is raised is that interstate branching might damage the dual banking system. But this also should not happen.

The current legislative proposals for interstate branching generally preserve States' authority to determine banking structure and otherwise regulate financial institutions within their jurisdiction.

Under these proposals, States would retain the current authority to control branching within their borders by national and State banks and to limit interstate branching by their own State banks. These proposals also permit States to impose on banks and branches within their borders certain State laws regarding fair

lending practices, unsafe and unsound practices, and community reinvestment requirements.

I should also comment here on the State tax issues that Senator Roth raised.

Those are complex issues, but we believe that they can be addressed. We note that many banking companies have leasing subsidiaries, which are very complex from a tax point of view, that operate in multiple States and things have been worked out so that it's not unfair to any State. Commercial finance companies operate all across the country and there are means in place for apportioning their income, State by State, that seem to work very well.

We would be happy to get the tax experts of Treasury involved in working with you to the extent that you feel is appropriate in working something out and we're confident that something can be worked out.

As I mentioned earlier, the administration supports the idea of further relaxing geographic restrictions. But in that process, we believe there are certain principles that should be followed, including: First, promoting efficiency and competition; second, protecting safety and soundness; third, meeting consumer and community needs; and fourth, respecting the interests of the States.

Additionally, we believe that any legislation to relax geographic restrictions should be kept separate from other issues so that it can be considered on its own merits.

One approach to reducing geographic restrictions that would accord with these principles would be to permit any bank holding company to acquire a bank in any other State unless that State opted out from such interstate acquisitions. Also, to permit the out-of-State holding company to consolidate any subsidiary bank with any of the holding company's other subsidiary banks and thus convert the bank's offices into branches of the consolidated bank, again, unless the State opted out of such interstate consolidations. And to permit the consolidated bank to branch within the State to the same extent as a State bank chartered in that State.

Such legislation can take effect some time, for example, 18 months, as in Senator Dodd's S. 371, after enactment. States could opt out at any time after enactment.

If a State did opt out of interstate acquisitions or consolidations, it would seem only fair that its bank holding companies would be ineligible to engage in such transactions themselves.

In any event, opting out should not invalidate any acquisition or consolidation that was lawful when made. This approach would permit banking organizations to structure themselves more efficiently and reduce their operating costs. It would benefit consumers and businesses by lower costs and greater convenience in the market for financial services.

Consolidating a bank holding company's interstate banks would not change the amount of banking assets under common control and should raise no new issues regarding concentration. The acquisition of new offices would be subject to concentration and competitive effects analysis by Federal agencies, as is currently the case.

Any relaxation of geographic restrictions should not be allowed to undermine banks' obligation to serve their local communities. In

this respect, it is useful to emphasize that all existing CRA requirements will remain in effect.

Again, Comptroller Ludwig will comment on this further, but part of the new approach that is being developed by the regulators will address market-related CRA performance that we think will be very useful in this regard.

This approach that I've been talking about has important similarities to S. 543, as passed by the Senate. S. 543 provided for bank holding companies to acquire banks in any State and to consolidate subsidiary banks into branches across State lines. It permitted States to opt out of interstate consolidations. It required separate CRA evaluations for each State and metropolitan area.

In these senses, S. 543 is broadly consistent with our views. We would be pleased to work with you in developing the specifics necessary for such constructive legislation.

Let me turn now to insurance activities briefly.

When considering appropriate activities for commercial banks, our two standard questions stand out in importance. First, does the activity contribute to the safety and soundness of the banking system? Second, does it on balance offer benefits to consumers?

The sale of insurance by banks under current law, conducted appropriately, can meet these tests. I should stress here that we're talking about agency functions, not underwriting. If banks were to get into underwriting, it would be a whole new set of risk management that would need to be addressed separately and here we're stressing insurance agency functions.

Recent experience demonstrates that the banking industry is not immune to economic difficulties. In fact, the industry has suffered long-term decline in the face of stiff competition from many less regulated providers of financial services.

On the asset side of the balance sheet, loans have been lost to the commercial paper market, commercial finance companies, insurance companies, and other competitors. On the liability side, funds have flowed in large amounts from bank deposits to mutual funds, and other financial assets provided by competing firms. Thus, in spite of today's healthy profits, we cannot be indifferent to the long-term strength of the banking industry. For many consumers, businesses, and communities, it remains the most important source of financial services.

We believe that national banks' insurance activities, under current law, pose no safety and soundness problems. In selling insurance, banks do not assume the risk of insurance underwriters and banks' capital remains unimpaired. This stands actually in sharp contrast to bank loans, where the bank typically assumes the entire risk of default.

Moreover, insurance sales can provide banks with the benefits of diversification. Diversification tends to increase and stabilize overall bank earnings and thus contributes to bank safety and soundness. Such stability can help enable banks to provide more credit to borrowers even in hard times.

We also believe banks' sales of insurance can benefit consumers through lower prices and greater convenience. In particular, a wider variety of bank products and services allow banks to reduce overhead costs per unit sold.

Insurance sales by banks, appropriately conducted, can also benefit consumers by reducing the time and effort expended in purchasing insurance. Greater convenience may be most important to consumers and small businesses in remote areas or low-income communities where the availability of financial services may be more limited.

This is one reason why current law permits national banks to engage in general insurance sales in small towns. Another reason is that the opportunity for such sales can encourage banks to locate or expand their operations to small towns.

On balance, we believe that selling insurance entails minimal risk for banks. In addition, we believe that consumers may benefit through increased services, greater convenience, and potentially lower insurance prices. For these reasons, we do not believe that the current insurance activities of national banks should be limited.

Mr. Chairman, let me close here, again, in the interest of time, as you noted. I do commend you and other Members of the committee for the seriousness and commitment you bring to these important issues and we very much look forward to working with you on them. I would be pleased to respond to any questions at the appropriate time.

The CHAIRMAN. Thank you very much.

Comptroller Ludwig, we'd like to hear from you now.

## STATEMENT OF EUGENE A. LUDWIG, COMPTROLLER OF THE CURRENCY, WASHINGTON, DC

Mr. LUDWIG. Thank you very much, Mr. Chairman.

As I've said before this committee previously, I certainly echo Mr. Newman's sentiments regarding your leadership of this committee. I've said it before, so I won't say it again. But I certainly share those views.

The CHAIRMAN. Thank you.

Mr. LUDWIG. I appreciate the opportunity to testify this morning. Because I've already testified on insurance, I will focus my testimony on interstate banking and branching.

However, before turning to that subject, I want to note three general points about bank insurance sales. One, acting as agent for the sale of insurance poses no safety and soundness problems for banks. Two, denying banks the benefits of diversification—that is, prohibiting banks from engaging in safe and sound financial business—over time, actually lessens the safety and soundness of the banking industry. Three, consumers benefit from bank sales of insurance through increased services, greater convenience, and the potential for lower prices from greater competition.

In short, Under Secretary Newman and I fully agree on these points, just as we fully agree on the importance of greater convenience to consumers in remote and low-income communities. Recognizing that service to remote communities can be limited, current law permits national banks to sell insurance in places of less than 5,000 in population. For the same reason, I agree with Under Secretary Newman that the idea of permitting national banks to sell insurance in low-income, inner-city communities deserves serious exploration.

I have a detailed written statement. In the interest of time, I would like to submit that written statement for the record and will discuss briefly a few important points this morning.

The CHAIRMAN. Without objection, it is so ordered.

Mr. LUDWIG. Point one—As my written statement discusses, interstate banking is a reality today. Every State in the Nation has acted to permit entry by out-of-State banking companies in one form or another. For the most part, banking firms with interstate operations are today required to do business through separately chartered subsidiary banks in each State in which they operate. The opportunity to have branches—rather than subsidiary banks—in multiple States is far less available. There are instances of it, but it is not common. To date, only nine States permit interstate branching, and all but one of these require reciprocation by the State in which the bank seeking entry has its headquarters. Because of the McFadden Act, only State banks that are not members of the Federal Reserve System may take advantage of those limited bank branching laws.

The current situation is inefficient and, therefore, wasteful. Requiring multistate banking companies to conduct their business through subsidiary banks—rather than through branches—for no good reason—drives up the cost of banking operations, and, therefore, banking services, and inconveniences consumers.

Point two—Any new banking activity should pass a two-part test. To be permissible under this test, a new activity: First, should not adversely affect safety and soundness; and second, should, on balance, benefit consumers of financial services—large and small businesses, as well as individuals. As detailed in my written statement, a fair application of this test clearly implies that Federal law should permit interstate branching.

Point three—On October 25, Secretary Bentsen announced the administration's support for a change in Federal law that would give interstate banking companies the opportunity to consolidate their banking subsidiaries into branching networks, with the approval, of course, of the appropriate State.

The administration supports interstate consolidation along the following lines. First, any bank-holding company could acquire a bank headquartered in another State unless that State opted out of such acquisitions. Second, an out-of-State bank holding company that owns or acquires a bank in a host State could consolidate its bank subsidiary into a multistate branch bank. Third, after such consolidation, the out-of-State bank would be free to branch anywhere within the host State, limited only by any restrictions that host State law places on intrastate branching. Finally, as I have indicated, States that preferred not to allow acquisitions and consolidation into branches by out-of-State banks could opt out of this approach.

I agree with Secretary Newman that, fundamentally, this is in accord with S. 543.

One of the advantages of this approach is that it builds on the strengths of the dual banking system. Federal law would not unilaterally grant banking companies the authority to establish de novo branches across State lines. As proposed, only the States could decide whether or not out-of-State banking companies could

convert existing subsidiaries into branches. State laws would also control the terms and conditions of additional branching within the State, as they do today.

Point four—Permitting banks to build interstate branch networks will allow them to provide more convenient and cost-effective service to their customers. Within each branch system, customers would be dealing with the same bank in every State and could make withdrawals and deposits in any branch and still have all transactions recorded as part of their account at the surviving bank, wherever it might be located. The banking organization itself would be more efficient in part because all the branches would have common policies and operating procedures. The inconvenience caused by multiple banks as opposed to branching is certainly in evidence in the Washington, DC metropolitan area, as it is in many metropolitan areas around the country.

My final two points relate specifically to safety and soundness.

First—Consolidation of operations into branches would not add to the risks of banking in any way. In fact, lowering costs through interstate branching has the potential to add to bank safety and soundness. To the extent that banks realize cost savings, they will be able to augment capital, directly strengthening the bottom line of both individual institutions and the industry as a whole, and thus directly improving safety and soundness.

Second—Consolidation would not harm bank supervision. Our oversight of large multibank organizations has prepared us to supervise consolidated interstate branch networks. Regardless of corporate form, our fundamental tasks will remain the same: Assessing the condition of each bank and the risks associated with its current and planned activities; determining if risk management systems exist and if they are properly designed; communicating with senior bank management about deficiencies; and validating the correction of those deficiencies. If anything, consolidation should permit the supervisory agencies to focus more sharply on the risks to the organization as a whole, to conduct a more efficient review of overall asset quality, and to provide a more accurate picture of the condition of the institution.

Now let me say one final word about CRA. We certainly are well aware that we cannot allow interstate branching and, as a result, have a degradation in CRA. Therefore, as part of the CRA reform initiative that we are currently engaged in, we will make certain that CRA principles are maintained, regardless of what corporate form a banking organization chooses to operate in, and we will more than likely do this on a market-by-market analytical basis.

In short, interstate branching would be an important change in the way that banks are permitted to organize themselves. It would permit banks to serve their customers better and at lower cost. It would result in cost savings for banks, which in turn would strengthen institutions and the system as a whole, thus enhancing safety and soundness.

I want to thank you, Mr. Chairman, and the Members of this committee. I look forward to answering your questions.

The CHAIRMAN. Thank you very much.

Senator Moseley-Braun, did you have a comment you wanted to make at this point before we start with the questions?

Senator MOSELEY-BRAUN. Yes, Mr. Chairman, I have an opening statement that I'd like to have entered into the record.

The CHAIRMAN. Without objection, so ordered.

## OPENING COMMENTS OF SENATOR CAROL MOSELEY-BRAUN

Senator MOSELEY-BRAUN. I suppose my preliminary observation, Mr. Chairman, is that this debate has been going on since Hector was a pup. Certainly as long as I've been involved in Government, this debate has fuelled controversy that seems never ending.

And in that regard, it seems to me that given the situation of not just banking standing alone, but the other financial services entities, that it would be sensible for us to take a look at this issue in the context of the whole issue of how financial services get provided, focusing in, not so much on the providers themselves and their interests, but the interests of the consumers.

We now have a situation in which CRA applies to some actors in the financial services market and not others, and in which the regulations apply to some and not others. And all of these dissonances in the regulations are, I think, in large part, responsible for the frustration that you get whenever you get out there, people saying, well, the Federal Government is all over the map in regards to banking regulations specifically, and financial services regulations in general.

So I guess I would want to discuss with the Chairman and the Members of the committee a mechanism for reviewing these issues, the branching issue in the context of CRA enforcement, in the context of other providers and consumer needs, what small businesses need in terms of access to capital, what consumer individuals need in terms of housing loans and business loans, the different institutions and entities, and financial services entities that play in these markets.

I think we really have to be comprehensive in our approach to this issue instead of just continuing to revisit, again, the debate that's older than I am. And so, that would be my observation, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Mr. Newman, let me ask you, at the start of your testimony, you said, and I want to quote, you said: "I am not here today to call for precipitous action in either area," meaning with respect to interstate banking and bank insurance activities.

I think it's important that we know exactly what action, if any, you and Mr. Ludwig are calling for today on behalf of the administration.

Mr. NEWMAN. Mr. Chairman, it's difficult to put an exact timeframe on it. But I think one way to interpret it is that we're prepared and would be very happy to sit down with you and the committee staff starting right away to work out some of the specifics that would be necessary to put together a bill of this sort on the interstate branching issues, addressing, more specifically, some of the States rights issues that have been raised, and the taxation issues that have been raised.

We would be happy to work with you on that and hopefully, that could be done in some reasonable length of time beginning shortly.

The CHAIRMAN. Would you add anything to that, Mr. Ludwig, before I go on?

Mr. LUDWIG. Bear in mind that the administration has a number of priorities, such as CDFI and other legislation, which Secretary Newman has indicated this committee has already acted on. However, consistent with the principles we enunciated, we would like to work with the committee aggressively to see that the interstate consolidation legislation is addressed promptly.

The CHAIRMAN. Well, let me make this suggestion to you. We do have other things coming down this track that we've given immediate attention to.

I would like to have this mark-up on November 18, 1993. Now, I recognize that we will not get to the floor this session. But I think it is very important that we have our work product finished, if we can, so we can get into the queue in the early part of next year.

We're going to be in an election year. That always creates a lot of excitement of its own. We've got the health care issue, which is very much going to be absorbing our time and attention.

So I want to shoot for having a bill ready to mark up on the 18th of this month. Now that gives us a very short timeframe, but you're here today because you've been thinking these issues through. You've got a philosophic and practical construct that you've developed.

I'm wondering if you could give us specific legislative recommendations on both nationwide banking and branching, say by the end of this week. I realize that we're halfway through the week, but this is not rocket science. We have been through these issues before.

I'd like to see if we couldn't perhaps sit down, achieve a meeting of the minds, and lock that into place and then go from there. Would that be something that you could assign people to do with us?

Mr. NEWMAN. Mr. Chairman, we'd be happy to work with you. But I need to tell you that that's an extraordinarily difficult timetable for us.

Even though, and clearly, you're right, you've addressed the issues before. Some of them, when you get down to the details, are complex and all of us have other issues going simultaneously, including trying to diligently get prepared to appear before this committee on November 17, 1993, regarding regulatory consolidation.

The CHAIRMAN. Right.

Mr. NEWMAN. And so we're working simultaneously on that issue and trying to give it proper attention. We'd be happy to work with you, but to be able to resolve all the issues that are necessary so you would have our views prior to a mark-up, making it by November 18 would be extraordinarily difficult.

The CHAIRMAN. Well——

Senator DODD. Mr. Chairman, if I could just intervene.

The CHAIRMAN. Yes.

Senator DODD. This is not a new idea. We've been dealing with this. You went down and listed the very concerns and considerations you have. Some of us have put together legislation which covers almost all of those points—the de novo branching, there are a couple of items that we could talk about. But you're right, Mr.

Chairman, this is plowed ground. We've been down this road here. We've passed legislation here.

There's a problem in the House. Nobody is suggesting that we're going to move precipitously in the House, obviously. But the Chairman is absolutely correct.

Let me just tell you. From experience, if you don't get in the cue early enough—and we're not talking about passing this bill out of the Senate before we leave here—you can basically kiss off this idea for this Congress, once again. It's hard enough, believe me.

If we were going to pass the bill in January here and get ahead of the cue on some of these other issues, it would take all of the efforts of this committee, for those of us who care about this, working diligently next year, to get something through the House and by conference before election next year. That's my prediction. If you miss that cue, if you wait until next year, you're into the spring, forget it.

Why don't you just say, we're not going to do this. We like the ideas. We're against the thing right now. I'd feel a lot more comfortable with that answer than going through a lot of hoops, a lot of work, to find out, frankly, I don't have the support on this.

There's a real fact, a timetable here, you've got to deal with. Some of us are willing to go to work and help you on this, but I think we need a little bit more candor. If this isn't a good idea, you're really against it, then I'd prefer the administration took that position, rather than sending a bunch of us off to go through a lot of work unnecessarily because I'll tell you right now, you wait until next year, interstate banking, forget your concerns about the other matters, it's as dead as a doornail.

Mr. NEWMAN. Senator, you are far, far more knowledgeable than I will ever be about that legislative process. I didn't mean to imply anything in that regard or any lack of support.

We very clearly do support this kind of approach to interstate, along with the principles that we just discussed. Much is very consistent with S. 543 and S. 371. The timetable issue that I mentioned to you in no way implied lack of support. It was just the practical issues, including the regulatory consolidation issue.

The CHAIRMAN. Well, that's why we're here today, to talk this through in a friendly, cooperative way, because we want to try to achieve these objectives.

But I want to underscore what Senator Dodd has just said. This legislative window that's open to us is a very complex one. It will close, and is closing, day by day, as we go through the remainder of this year and go through the period that the Congress will not be in session and coming back in.

One of the reasons that I chose not to seek a fourth term in the Senate is that I want to get this legislative agenda, as much of it as we can, accomplished in the window that I see open.

We may find that after 1994, we've got a very different legislative lay of the land around here, quite frankly. Just look at yesterday's results. I'm not putting it into a partisan context, because we don't operate on a partisan basis here.

Senator MACK. I did observe the outcome of those elections yesterday.

[Laughter.]

Senator DODD. I've got a list of a bunch of municipal elections in Connecticut where we did really well.

[Laughter.]

East Haddam, Bosra, Chester.

Senator MACK. That's encouraging.

The CHAIRMAN. The bottom line is that this is not a new issue, this is an issue that's been worked through before. We've legislated upon it here. We've taken it through this committee. We've taken it through the Senate floor. I think we can sit down together and talk through the issues.

We don't have endless hours to spend on this if we're going to get this done. That's not to try to create an undue burden or an extra burden, but just to make it plain that this is something that I think we can accomplish. But it does require a real acceleration of effort here.

Senator MACK. Mr. Chairman?

The CHAIRMAN. Yes.

Senator MACK. The only comment I would make, in listening to discussions so far, while it may be something that the administration supports, it sound like, though, that it doesn't have the kind of priority that is needed in order to get it done for next year.

The CHAIRMAN. Well, I think that's what we have to establish because I don't want to put that reading on it yet because they may have made an assumption about how much legislative time there might be available. I think what they're hearing from us now is that we're in a very tight legislative time situation. And in order to be able to meet an objective of getting this enacted next year, we really have to move and we've got to hit this timetable.

We can slip a day or two or three, but we can't horse around here and slip past this session of Congress. That's why we've done all this work leading up to today. We've got to really engage this quickly. You've got a committee willing to do that. You've got bipartisan support that you've heard expressed here today.

That doesn't settle each and every technical issue, but if we're going to get bogged down on technical issues at the cost of the larger principle we're pursuing, then we're always going to be behind the curve.

Here's what I'd like to ask you to do. I'll be back in a moment because we're on the second bells of this vote. I'm going to ask you to stay because I think we need to pursue this a bit further before we move on to our next witnesses.

I'd like you to assign a team, a joint team, to work with our staff. I want to try to meet this timetable. If we find we've got some impossible issue here that nobody's ever thought of or had to work through before, then that may create a different situation. But I'm frank to say I don't know what that is because we've been through this before.

I think it's time to decide these issues, lock in on a product, and bring it through the committee. Let's mark it up. Let's get it out. There will be time between the floor and the time the committee acts. But I think it's essential that we get this train moving down the track here.

So, with that, let me just put the committee in recess here. We'll go over and vote and we'll come back, and then hopefully we can finish this discussion.

The committee stands in recess.

[Recess.]

The CHAIRMAN. The committee will come to order.

We had a chance during that brief recess for the vote to talk a bit. This is what I'd like to propose and the way we'll move ahead here.

At 4 p.m. today, I would like to be able to give to you a draft proposal on this issue that you can react to and make suggestions about with respect to your staff people. I want to stick to the time schedule I've laid out because I think, as you made clear to me, this is something you want to try to accomplish in this session of Congress, sometime between now and the adjournment next year.

As Senator Dodd and I and others look at the legislative calendar, in order to be able to be in a position to get this done, we feel we've got to stick with our timetable now. We think we can. We think we've got a bill here that addresses these issues quite directly and if you have suggestions you want to make, well, you'll have an opportunity to do that coming into the mark-up, and then there will be a period between then and the time of floor action, and there are various stages down through the process.

But I'd like to leave it then that it's my understanding, and I'm going to let you comment on this when I finish here, so we really understand whether we're laced together here, that the administration does want to move the interstate banking issue in this Congress, that that is a specific legislative objective and priority, and that you are prepared to work with us, although the timing is tight, in a way that lets us incorporate as much of your view and thinking as we can.

I want to stick to my mark-up date because I need to do that in order to assure that we've got the kind of running start into this that we need. And I will then give you this package, so that you will have it available to work with your staff people this afternoon. I think the time has been set for 4 p.m., so that we can really engage on the specifics here.

Having said that, let me invite your response, Secretary Newman and Comptroller Ludwig, and then I'll invite Senator Dodd to make any comments he has.

Mr. NEWMAN. Well, I guess, Mr. Chairman, we're going to have to stop going home at 2:30 p.m. every afternoon.

[Laughter.]

We'll do the very best we can to work with you to address at least the most important issues. Secretary Bentsen had emphasized previously that we want to proceed deliberately and carefully. These are very important issues. We do want to see action taken on interstate banking. We think it's a very important public policy issue. We just wanted to make sure that it got careful, deliberate attention.

We will do our best to give you our thoughts on the most important issues, at least, in the timeframe that you're talking about.

With respect to insurance, I think we've been pretty clear about that. We believe it's a separate issue. We don't believe that there's

any need for any action at this time. And so, we'll be concentrating on the interstate matters.

The CHAIRMAN. Mr. Ludwig.

Mr. LUDWIG. I would echo Secretary Newman's comments, adding that we will commit our resources to be helpful and reiterating the Secretary's call for a deliberative process. I'm sure Secretary Newman agrees that while it may be desirable to move an interstate bill this Congress, from an administration perspective, it really will depend on the substantive result we reach. We'll work with you very aggressively to try to meet your timeframe and get this thing done. At the same time, we want to attack this in a deliberative way that achieves a good result. If it cannot be done this Congress, that would be too bad, but it may well have to be the case.

The CHAIRMAN. Senator Dodd.

Senator DODD. Well, thank you, Mr. Chairman. We certainly appreciate getting this so that we can get the mark-up occurring. And as I pointed out, there are a lot of different ways to skin cats around here. I appreciate, and we'll go through some questions regarding the insurance provisions, which you've expressed clearly, your views on.

One of the painful lessons you learn in this town is we don't always all get our way on everything. Ultimate pieces of legislation involve a lot of involvement from a lot of different sources that, hopefully, is more right than wrong.

So I would just invite you, and knowing how many times we've tried in the past to deal with these issues unsuccessfully, the opportunity to do so. And furthermore, the court's invitation on the latter issue, by the way, just inviting the Congress to speak on this one way or the other, is something that I intend to pursue.

I may lose on it. So be it. I would not abandon interstate banking if I lose. I would hope the administration and others would not take a position that they're willing to abandon interstate banking if you lose something in this matter.

I think interstate banking is a very important issue. This other issue is important to people. I realize that I don't think it's as important as whether or not we have interstate banking.

My part of the country went through misery because we didn't have alternatives in the credit crunch in New England. We suffered terribly as a result of that. And, for the reasons that I've outlined earlier, I think it's very important that we move in this area.

The survey you conducted among other nations of the world, in terms of where they are in these issues, is an indication of how far behind we are. I've said this many times, Mr. Chairman, in the past, but it's one thing to lose market share in labor-intensive industries and things that none of us like to see. But for us to lose market share globally in financial services because we sat around in the 19th Century in our thinking, and then those who sat around and decided to hold up things because they didn't like a town of 5,000 provision, I think are going to have to face a judgment on that.

I certainly care about it, but I would never abandon my efforts for interstate banking because I didn't get my way on that one at all.

I just hope that there will be some broader, longer term thinking on these questions than some of the problems that we faced in the past. I'm encouraged by the comments here that we'll be able to have a mark-up on the 17th, and let the chips fall where they may on these issues and we'll move forward.

Thanks.

The CHAIRMAN. Well, we'll have the meeting, then, at 4 p.m. this afternoon and let's see if we can't move this process along. I think it's very important to do that.

Let me ask, Mr. Newman, one issue that you did not discuss in your testimony is de novo branching. On page 6, however, of his testimony, Comptroller Ludwig states that:

> National banks and State-chartered banks would not be permitted by Federal law to establish de novo branches, although States would be free to permit entry by branching as they are today.

Is it correct to assume, then, that the administration prefers a State opt-in for de novo branching?

Mr. NEWMAN. If the bill were to address de novo branching at all, which we don't think is necessary, actually, we don't think it is a key part of the problem right now, but if it were to address it, clearly, we think that that ought to be up to the individual States. We'd be very reluctant to tell a State what it can and cannot do in that regard.

The CHAIRMAN. The 1991 bill passed by the Senate provided that only adequately capitalized and adequately managed banks should be permitted to expand interstate through acquisition.

Some of our witnesses later today recommend that such expansion should be limited to only well capitalized and well managed banks. What are the views of each of you on that question?

Mr. LUDWIG. FDICIA sets down markers that are not far from that concept, that is, that a bank has to be adequately capitalized, essentially. And, we certainly take into consideration the overall condition of the institution and its ratings when we approve applications.

I think it is dangerous to hard-wire in lines here because you can find situations where an institution has not done well but is beginning to recover and an acquisition might help it recover further and help a banking market. You wouldn't want to hard-wire in something that prohibited what might be an activity that would benefit consumers and make these institutions safer.

I think FDICIA set a thoughtful line, and I would be inclined to simply go with that. I think we have the regulatory controls in this area that we need.

Mr. NEWMAN. I would just echo that, Mr. Chairman. I think the regulatory authorities do a very effective job of reviewing the financial condition and prospects and the management capability of institutions when they are in the normal process of approving mergers and acquisitions. I don't think any additional statutory requirements would be productive.

The CHAIRMAN. Senator Moseley-Braun, when she was here, was raising the question, as others have, and as I have as well, about the availability of credit and whether that gets squeezed down in an interstate banking situation.

Let me ask you both what you think needs to be done to assure that some inner-city and rural areas, that now have a tough time getting credit, would not be left behind if interstate banking is permitted.

Mr. LUDWIG. I feel very strongly that you simply cannot have a system that makes any sense where interstate consolidation would beggar CRA. It's very clear what Congress had in mind with CRA and that was an institution servicing all its markets, not simply choosing the market of its home office. The revised CRA will clearly reflect that intent.

Mr. NEWMAN. Again, I would just echo that, Mr. Chairman. The mere act of consolidating banks that are separate subsidiaries now into branches of a larger institution really shouldn't affect the credit availability one way or another. As a matter of fact, if anything, it might help.

But we are very serious about just overall insisting that banks meet their responsibilities to their communities and that banks do make loans available to people of all walks of life in a very fair fashion.

We also have on our agenda, to consider in the future—we made mention of this publicly before—some look at what might be appropriate for assuring that fair lending and community responsibilities are undertaken appropriately by nonbank institutions. But that would be something we'd probably want to study pretty carefully next year.

The CHAIRMAN. Let me just ask one final question and go to Senator Dodd.

I want to talk about insurance sales in distressed communities. We've talked some today about the town of 5,000 provision. Congress enacted that provision to encourage banks to locate in small towns which were underserved by banks.

We've got economically distressed urban and rural areas now that continue to be underserved by financial service providers. In the past, Comptroller Ludwig, you've said that you favor allowing banks in low-income communities to sell insurance.

Would allowing banks in distressed communities to sell insurance to individuals and businesses in those areas encourage banks to locate in those communities? And would you support such a provision?

Mr. LUDWIG. The concept of allowing banks to sell insurance in low- and moderate-income communities, particularly inner cities, is something we support. We are looking at that concept in a disciplined way in the administration.

Some call it a loophole, but if you look at the town of 5,000 statute and the legislative history, what Congress apparently had in mind was two things. One was to locate institutions in towns of 5,000 in order to provide services to those towns. Another was to locate institutions there to encourage activity in the towns. The hope was that they would grow in the town and provide a source of employment.

Similarly, the benefit to the inner city would not be simply that the sale of insurance by banks would take place in the inner city, but that they would be potential poles of development. That is, if a bank were to locate in the inner city, it could sell beyond the

inner city as a way to expand employment and economic development in that location. That concept reflects the original intent of the town of 5,000 so-called loophole, and we're taking a hard look at it.

The CHAIRMAN. Anything to add?

Mr. NEWMAN. No, Mr. Chairman. Our views are consistent on this and my written testimony had essentially the same comment that Comptroller Ludwig made.

The CHAIRMAN. Senator Dodd.

Senator DODD. Let me just pick up on Mr. Ludwig's last point. I appreciate your description of what you believe the legislative intent was with the town of 5,000. I suspect you would not, however, suggest that what the authors of that legislation intended was that the town of 5,000 also become the base of operations for a nationwide selling effort.

Mr. LUDWIG. Senator Dodd, they didn't put limits on it.

Senator DODD. Clearly, that was not the intent. The purpose of it, in a sense, if that was the intent, initially, they would have allowed that to occur nationwide. Why would they go through the process of trying to just confine this to small towns if the intent was to sell it nationwide?

Mr. LUDWIG. The theory was that you can only sell beyond places of 5,000 if you locate in places of 5,000, as a means of encouraging institutions to set up there. In that way, towns of 5,000, which were not only underserved but were viewed as somewhat underdeveloped, would have a pole of development. That's the theory, and it is reflected in the legislative history.

Senator DODD. I totally disagree with your reading of the legislative intent. That's what's happened, in effect, and there's a good argument to be made and you're making it on allowing this activity to occur. But I think it's a distortion.

Let me, if I can, move into a couple of areas briefly. One is, how much information do you have on the sale of annuities, life annuities and insurance by national banks right now? Do you have a lot of good data on that?

Mr. LUDWIG. We have some data on it.

In the town of 5,000 case, the courts agreed with our interpretation. In the annuities case, the 5th Circuit recently went the other way and said that annuities are insurance, not a banking product. The only way, therefore, that a bank could sell them, since they are considered insurance, is through something other than the incidental powers clause. A bank could sell annuities through the town of 5,000 exception, but, otherwise, the court said a bank cannot do so because annuities are an insurance product.

Senator DODD. But that's not your view. Your view is that they should be allowed to do it.

Mr. LUDWIG. My view is that they should be allowed to.

Senator DODD. Without having the kind of information, not knowing the extent to which this occurs, how would you plan to regulate it?

Mr. LUDWIG. The extent to which——

Senator DODD. Annuities.

Mr. LUDWIG. I would not characterize bank sales of annuities as vast. We at the OCC are working very hard to collect better data on all products and services. I want to have detailed data.

Senator DODD. Hopefully, in your thinking, you hope they become vast.

Mr. LUDWIG. I wouldn't say that I would go that far, sir. I would say that I think it's up to the institutions and the markets to decide how big those activities become or don't become.

Senator DODD. Is there any doubt in your mind that it's going to become a pretty good activity if you prevail, your thoughts prevail on this idea?

Mr. LUDWIG. I think it's likely to become significant.

Senator DODD. Why should we regulate? Every other financial institution that deals in these areas is regulated? Why shouldn't banks be regulated if they're going to engage in this activity?

Mr. LUDWIG. I certainly think they ought to be regulated. I think there are consumer issues of some import that we ought to take seriously. There are tying concerns. I certainly don't think a bank ought to condition the provision of credit on the sale of insurance—you can't get this credit unless you buy my insurance. That's illegal, and I do not think it should be permissible. Similarly, when somebody buys an annuity product from a bank, I feel very strongly the consumer ought to know that it is not a federally insured product. So there are ways in which I think we have to regulate bank sales of insurance and will.

Senator DODD. Well, you highlight, of course, some of the very problems that you can end up—and the major concern I have with this is that whole tie-in approach, and particularly in areas where you have a lot of economic concentration and very few consumer options, whether it's the concerns over the sale of real estate.

I don't know what your parameters are in terms of what banks ought to be allowed to engage in as far as agency, general agency activities are concerned, other than having some language that prohibits tie-ins.

But human nature being what it is, I think you run the real risk of exactly the result you're talking about. You might be able to have some efforts to try to stop it, but I think if you end up with other people being out of business in that area, it really becomes a fait accompli.

Mr. LUDWIG. You know I have a considerable respect for your views, Senator, and you're making very good points in terms of consumer well-being that we take very seriously. However, other financial entities, Merrill Lynch, for example, are not locked out of selling multiple financial products. And as we move into an era of financial products where we have a large range of things that a consumer can purchase and wants to purchase, locking banks out of that expanding market makes them less safe and sound and the whole system less safe and sound. In some ways, it just doesn't make any sense. Why should this one sector of the economy be so very, very limited?

Senator DODD. Well, I'm not trying to—well, technology has changed and I'm a clear advocate for trying to make sure that there's a greater availability of capital making these institutions

stronger and the like. I also have enough caution in that human nature hasn't changed since a lot of these laws went into place.

I wish it had. But the desire to drive the competition out of business is as healthy today as it ever was. The ability for consumers to be able to have those choices, when you and I both know that your ability to get that loan is also going to be, whether it's done with a wink or a shrug or whatever, it gets pretty clear.

You don't have to be a rocket scientist to figure out what's going to make your ability to get that loan approved. That's a real danger here. And ending up with that kind of consolidation of power goes to the very issues that others have when they raise the concerns about interstate banking, in a sense.

That's my concern. I'm not opposed to having people legitimately get involved in activities that I'm comfortable they'll be able to do. In fact, I encourage it. But I'm nervous about what we're permitting here and the potential liabilities. And if we deal with some of the interstate issues, it seems you address the safety and soundness question and there are other means of doing that. Having an open-door process on agency activity, not regarding the consumer interest is, I think, precarious.

Mr. LUDWIG. I very much respect your views. You raise genuine concerns.

I'd only say two things. First, only 54 percent of the loans in this country are being made by banks and other insured depositories. That's barely the majority of loans. Twenty-six percent of the assets, and it's declining, are held by commercial banking organizations in this country. So they're not the whole financial sector. They're really a fairly small part of it.

Second, I've been all around the country. In Los Angeles, I walked the streets of Watts. I've been in inner-city New York and inner-city Washington, DC. I've heard this again and again. In inner-city Washington, DC, a nurse came up to me, and I've had this happen repeatedly, and said, "I got a loan to buy my house. I'm very excited. It's the first house I'm going to own. But I can't get insurance." It's as if Cinderella is allowed to go to the ball, but she has to have a fancy dress and she can't get the dress. So the nurse couldn't buy her house. Isn't it sensible that when she applies for her loan, she at least has the option of being able to get that insurance, which she must have or she can't get her mortgage?

Senator DODD. The assumption the bank is going to give it to her, I could raise some real monsters with the notion that they're going to give her the insurance whether or not she deserved it.

Mr. LUDWIG. You can't buy the house without the insurance.

Senator DODD. Well, I understand that. But a lot of these independent agents, of course, represent a range of companies, not just a particular insurance company. In many ways, they're better suited knowing that business, being involved in it all the time, to serve the interests of that particular consumer because that's what they do every day and know what options are available to someone.

The fact that she has one opportunity, and one opportunity only, in that neighborhood necessarily to get insurance is what I fear.

Mr. LUDWIG. I respect that. Insurance agents have done a great deal in this country. They're a respected part of the society. In my little hometown of York, Pennsylvania, I grew up with a fellow who

is the head of the biggest insurance agency and he does a whale of a job for the community. I think there have to be the kind of consumer protections and protections in terms of fairness in the marketplace that you've pointed to. But I think that's short of a prohibition on bank sales of insurance.

Senator DODD. How about licensing requirements with regard to insurance activities? Who would you have assume that responsibility? Are you going to assume that responsibility or are we going to have the States continue to do it?

Mr. LUDWIG. I'd be pleased to address that question in writing and get back to you on it.

[The following information was subsequently submitted for the record:]

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

December 13, 1993

The Honorable Christopher Dodd
United States Senate
Washington, D.C. 20510-1302

Dear Senator Dodd:

I am pleased to respond to the question you raised during the November 3, 1993 hearing on proposed interstate banking and branching legislation. Specifically, you asked for our views on licensing requirements for national banks engaged in insurance activities. We look forward to working with you and your committee in resolving these very important issues for national banks.

It is important at the outset to distinguish between state insurance licensing requirements that prohibit national banks from exercising permissible powers conferred by federal law and those that do not. The OCC has in the past concluded that state licensing requirements that may prohibit a national bank from engaging in an insurance activity that is otherwise permissible under federal law are preempted by that federal law. The OCC, however, does not maintain that all state insurance laws relating to the insurance activities of banks are preempted but rather makes such determinations on a case-by-case basis. As the OCC has stated in the past, particular state insurance laws may be applicable to national banks because they do not conflict with national banking laws. Moreover, the OCC has recognized the special interest of the states in the regulation of insurance and, therefore, does not assert that national banks are prohibited from complying with appropriate state licensing requirements.

It is also the OCC's position that the McCarran-Ferguson Act does not provide an independent basis for a state to impose licensing restrictions that may prohibit national banks from engaging in insurance and insurance-related activities that are permissible under federal law. As you are aware, the Act provides states with the authority to regulate the "business of insurance." Specifically, the Act provides that:

> [N]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance...unless such Act specifically relates to the business of insurance.

The Supreme Court has held that the Act protects a state law from federal preemption only if the law is for the purpose of regulating the business of insurance. Federal courts that have addressed this issue in connection with national bank insurance powers have concluded that state licensing laws that prohibit national banks from engaging in activities otherwise permissible under federal law are not protected from preemption by McCarran-Ferguson.

I trust that this letter responds to your question. Please do not hesitate to contact me or my staff if I can be of further assistance.

Sincerely,

Eugene A. Ludwig

Senator DODD. Well, you see, that's just another aspect of all of this. You start getting into who's in charge. One group coming and looking at one thing, it gets very complicated and dangerous. Anyway, I expressed these views so many times, the Chairman is tired of hearing me say it.

I'd point out, by the way, that this is not an issue that is necessarily a company issue. In fact, the companies rather put—quiet is a generous description. This is an activity that—we've modified this, by the way, over the years, as the Chairman knows. There has been some real movement in some of these areas over the years.

At any rate, Mr. Chairman, I don't know if you have any comments you want to make, Frank. You've been intelligently quiet in staying out of this discussion.

[Laughter.]

Mr. NEWMAN. Thank you, Senator. I'll jump in a little bit. Mr. Ludwig and I are very much in agreement on these things. We go back to our two-part test that we share. Secretary Bentsen has also mentioned—does it help or hinder safety and soundness? We come up with the conclusion that, if anything, it helps safety and soundness for banks to be able to sell insurance.

The second part of the test is, on balance, does it benefit or harm the consumer? We believe that, on balance, appropriately conducted, and that is in our testimony. It's an important qualification. That it can benefit the consumer.

Appropriately conducted means with supervision that would prevent the kind of tie-in problem that you mentioned. I can tell you, from somebody who has been on the other side of the supervisory process, being regulated, that I think the regulators do a very fine job. We believe that the existing legislation gives the regulators sufficient power to make sure that the offering of services such as insurance or mutual funds or other nontraditional services, are not improperly presented to consumers and it's really up to the regulators to enforce that.

I have every confidence that Comptroller Ludwig will do that.

Senator DODD. Let me just last—Senator D'Amato and Senator Kerry and I have introduced our own interstate banking bill. I listened to you enumerate your concerns—safety and soundness, community needs, the States' ability to opt out, and efficiency, I think were the four general headings you described.

All of those items are in our bill, I think. I don't know if you had a chance to look at the bill we've introduced. And if you have, I'd like your general comment on it.

The de novo branching is one I think we're a bit different on, but I'm willing to listen. You've made an articulate description of your concerns about that. Are there any other provisions of our bill that you've looked at that you disagree with?

Mr. NEWMAN. Senator, I don't think, off the top of my head, I'm prepared to give you that kind of response. We have gone through it, just as we've gone through S. 543, in detail. We'd be happy to get back to you and maybe in this process of working together over this next period of time, we will deal with that.

But I can tell you that the thrust of S. 371 is one that we feel very much in concert with, but would like to take the opportunity to go through the individual details.

The point about the de novo branching, again, primarily is that when we look at what it is that needs to be fixed, where are the major problems, the vast, vast majority of them have to do with consolidation, not de novo entry. De novo entry presents new questions which would need to be resolved, and we just don't see a need to be diverted for that.

We have an opportunity, we believe, to focus the attention on the major issues where the problems can be resolved very readily and proceed ahead with a clean bill.

Senator DODD. I think that's a very good point. Are there any States left that don't allow intrastate branching? Colorado, I think, was one of the last. Have they changed on that?

Mr. NEWMAN. Every State now provides for some form of interstate banking.

Senator DODD. Intrastate.

Mr. NEWMAN. Intrastate. Although there are some States that still have restrictions that don't allow the full State-wide activity. It's located—it's maybe a region or a county.

Mr. LUDWIG. Some States are now phasing in. For example, Arkansas was a unit branching State that is in the process of a phase-in. If there is a unit banking State, it would be one I don't believe——

Senator DODD. I may even be wrong on Colorado. I thought they were one.

Mr. LUDWIG. They may be. I'm not certain about that. But the States are basically all limited branching or free-branching States.

Senator DODD. Well, I think your point on that is fair and I wouldn't disagree with that. That's something that I think is fine.

But I agree with you, that if it's going to cause a problem in terms of the other goals which are far more important, then I'm not wedded to that absolutely. It seems to me that other issues are more important.

Mr. Chairman, thank you.

The CHAIRMAN. Thank you, Senator Dodd. Let me just make one final statement and then we'll thank the two of you.

Back in May of last year, I asked the GAO to "examine the impact that interstate banking and branching would have on such matters as the safety and soundness of our banking system, on concentration in and structure of the banking industry, and the ability of the U.S. banks to compete abroad." Those are all in quotes. Those were the charges to the GAO.

Although my staff has seen drafts of the GAO study as it progressed, the final report was just completed and has actually been furnished to me today. I want to ask unanimous consent that my requesting letter and the GAO Executive Summary of the report be included in today's hearing record so that it's publicly available.

Without objection, that is so ordered.

In addition, on August 31, 1993, I wrote to Mr. Ludwig and asked for information about concentration in the banking industry. And on November 1, 1993, he replied and noted, "that the available

evidence suggests that concentration in the banking industry is not excessive."

You also endorsed with the reply a detailed report—I should say you also sent along with your reply a detailed report on concentration in the banking industry prepared by the OCC's economic staff, and I appreciate that.

So I also ask unanimous consent that my letter of August 31 to you and your reply of November 1, and its enclosure, also be included in the record at this point in today's hearing.

I think that that lays an important part of the foundation out there in terms of the analysis that's been done.

And without objection, that is so ordered.

Let me thank you both and excuse you both. We'll rejoin this at 4 p.m. today and through our various agents and representatives see if we can't move ahead.

Very good. Thank you.

Mr. NEWMAN. Thank you, Mr. Chairman.

The CHAIRMAN. Let me now invite our remaining panel to the table: Barbara Walker, who is chairman of the Legislative Services Counsel, Conference of State Bank Supervisors; Gerald Noonan, who is president and CEO of the Connecticut Bankers Association; Rev. Charles Stith, who is the national president of the Organization for a New Equality, from Boston; Susannah Goodman, who is a policy analyst for Public Citizen, based here in Washington; and Ballard W. Cassady, Jr., who is executive vice president of the Kentucky Bankers Association.

So let me give you all an opportunity to find appropriate seating and come forward. When you're ready, we'll start.

Thank you all for being here. We'll make your full statements a part of the record. I'd like to ask you to summarize as much as you can so that we can have the essence of your views and then we can go from there to questions.

Ms. Walker, we're going to start with you. We're pleased to have you and we'd like your comments now.

## STATEMENT OF BARBARA WALKER, CHAIRMAN OF THE LEGISLATIVE SERVICES COUNCIL, CONFERENCE OF STATE BANK SUPERVISORS, WASHINGTON, DC

Ms. WALKER. Thank you, Mr. Chairman.

I appreciate the opportunity to share with your committee the views of the CSBS on the important issues involved with interstate banking and branching.

Legislation must set into place a framework for a rational progression to nationwide interstate branching. In 1991, the Senate approved a proposal that allowed States to opt-out of interstate branching. This proposal creates a number of problems for the States. Five areas of critical concern are effective date, applicable law, conditions, parity, and taxation.

The critical question regarding the effective date is how long to give the States to act. CSBS strongly believes that States should be granted a full 3 years from the enactment of any opt-out proposal to consider interstate branching.

How an interstate branch will operate within a State is governed by the applicable law provisions. These sections dictate what pro-

tection will be provided to consumers and communities in the interstate branching environment.

This committee crafted a compromise on applicable law in 1991. It identified four areas where State law would apply to the branch of an out-of-State bank as if it were a bank chartered by that State. These areas were intrastate branching, consumer protection, fair lending, and community reinvestment.

Unfortunately, the Ford Amendment stripped away most of the language and reversed the impact of the provision. We urge you to adopt the applicable law section of S. 543 as approved by this committee in 1991.

Similar to the applicable law provisions, this committee included a section in its version of S. 543 that permitted States to set certain nondiscriminatory conditions on the entry and operation of interstate branches.

The Ford Amendment eliminated this provision from S. 543. By not permitting State conditions, interstate branches will have a competitive advantage over in-State banks and over those institutions that choose to retain separate subsidiaries. In addition, nondiscriminatory conditions that currently apply will be lost, thereby significantly reducing State oversight of the institutions that offer financial services in the State. We ask that this provision be restored.

With regard to parity, under all interstate branching proposals in Congress, additional State action is required to allow State banks to branch interstate. While this power should remain with the States, there must be sufficient time for the States to act on interstate branching.

CSBS appreciates the willingness of this committee to address the concerns with the impact of interstate branching on State revenues. There are several provisions in the legislation from 1991 that directly address the State tax questions.

It is important to note that no further Federal "fix" is needed regarding State taxes in this legislation. The States have the authority and the tools necessary to devise a taxing method that fairly apportions tax revenues among the States where a multistate branch bank operates. This already is a matter of a great deal of discussion and work among the States. However, more time is required.

The Multistate Tax Commission is currently working on a draft proposal to tax multistate banking operations. The draft is due to be presented in mid-1994. After that, individual States must study the proposal and adapt it to their individual tax systems.

Let me now turn to the issue of consolidation. From the State perspective, consolidation creates the same problems as any other interstate branching method and raises several new concerns as well.

First, it is extremely unfair to smaller institutions. In addition, to the extent that there are any consumer benefits of interstate branching, very few new consumer benefits arise from consolidating existing banks. Consolidation raises all of the State concerns with respect to applicable law, parity, and taxation discussed above.

Consolidation creates a concern about the ability of States to enforce agreements entered into with out-of-State banks under the

Douglas Amendment. Any consolidation proposal adopted must contain an opt-out and should have a minimum of 3 years prior to becoming effective.

There will be some benefits to interstate branching. These benefits will be localized and not greatly significant.

The proponents of interstate branching tend to overstate the benefits. One area where this overstatement is particularly evident is the projected cost savings to the industry from consolidation.

If every multistate bank holding company fully consolidated, our analysis shows a total savings at most of approximately $750 million per year industry-wide.

CSBS prefers the opt-in approach to interstate branching. It allows States to adapt interstate branching to local needs in the same way that interstate banking evolved under the Douglas Amendment.

If the committee decides to go forward with an opt-out proposal, we urge you to allow a full 3 years for State action. We also strongly urge you to address the concerns I discussed previously.

The CSBS would also like the opportunity to submit to the committee its positions on banks and insurance powers. We have not addressed that in our written or oral statements, but I'd be happy to answer any questions that you may have.

Senator DODD. I'd like to know what you're going to say about it before I'll agree to accept it.

[Laughter.]

Ms. WALKER. Thank you.

The CHAIRMAN. Thank you very much. Mr. Noonan, we'd like to hear from you now.

## STATEMENT OF GERALD M. NOONAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONNECTICUT BANKERS ASSOCIATION, HARTFORD, CT

Mr. NOONAN. Thank you, Mr. Chairman, our own Senator Dodd.

At the Connecticut Bankers, we represent over 85 percent of the financial institutions of Connecticut, no matter what charter—savings and loans, savings banks, commercial bank, nationally chartered, et cetera.

It's our feeling that the interstate branching issue is one that is really primarily driven by economics and by the rapidly changing communications and technology industries. If we did nothing, I think that interstate branching would continue to move forward on a State-by-State basis.

It's our feeling that that kind of haphazard approach is not something that the Federal Government, through the Congress, should allow to happen. We think that the Congress should play a leadership role and we support basically the language of S. 543.

We're not married to anything in it, really, because we do think that eventually, it will come. We liked a number of the aspects and many of the items that were just mentioned, such as opt-in and opt-out. Most of our members don't get all excited either way.

What we know is that to do it nationally, you have to build a broader consensus than just the banks of the State of Connecticut.

So that your mission really is to make sure that out of all 50 States, those that have different powers can be helped. Again, we

have parity laws in Connecticut. We've had them for years. There's no real powers differences and there are States that don't have that. So they may have different problems.

As far as we're concerned, we would just like you to move forward on the issue. It's not the end of the world if you don't, but we would see it as a shame because we think that really, it's Congress role to show us the way in an area that we're going to get to, anyway. But we will have to do a lot of stumbling to reach that resolution.

Thank you.

The CHAIRMAN. Thank you very much.

Rev. Stith, we're pleased to have you and we'd like to hear your comments.

## STATEMENT OF REV. CHARLES R. STITH, NATIONAL PRESIDENT, ORGANIZATION FOR A NEW EQUALITY, BOSTON, MA

Rev. STITH. I appreciate being here, Mr. Chairman.

I head the Organization for a New Equality. One of our projects is the National Community Reinvestment Network. We have about 80 affiliates around the country.

It runs the gamut from the Greenlining Coalition out in California, which has negotiated about $19 billion in agreements with banks in that great State, to the Dalton Community Reinvestment Coalition. It's a struggling grassroots organization down in Dalton, Georgia.

I want to zero in on one specific aspect of this matter of the expansion of bank powers that I think could be mutually beneficial to banks as well as inner cities.

We would favor a carefully and narrowly crafted piece of legislation that would permit banks with outstanding records of serving the inner city to sell insurance in the inner city.

Our proposal is based upon several prerequisites, the first of which is that there must be substantial reform in the Community Reinvestment Act, so that CRA ratings are based on performance and full disclosure by race, ethnic background, and gender, and that this disclosure include business and consumer loans, as well as home loans.

Earlier, during his testimony, Comptroller Ludwig made mention that he felt it was important to observe the principles of CRA as you deal with the issue of the expansion of bank powers. He's been one of the strongest advocates ever to sit as head of one of our regulatory bodies on this issue. But I'd go one further and say that I don't think it's enough to maintain the present principles, that we have got to strengthen the Community Reinvestment Act.

Second, I'd say that the eligibility for expansion be limited to banks that receive an outstanding or highly satisfactory CRA rating. Again, this rating would have to be based upon new performance-based CRA ratings. And that the sale of insurance by banks be limited to inner cities and other areas where there is limited competition and redlining by insurance companies.

We would argue further that there should be a full review in 2 years to discuss possible further expansion of bank powers in this area.

Now, our reasons for supporting this modest expansion, one predicated on several points, the first of which is that insurance companies in this country do redline. There have been substantial data provided to Congressman Kennedy's Banking Subcommittee on this subject. The abuses run the gamut from a Texas auto insurer, who refused to insure someone's car because they didn't own a home, to the LA riots that last year took place where 80 percent of the merchants in that area have yet to be paid on their claims because they've had to secure insurance from offshore insurance companies.

In Los Angeles there has been about $2 billion worth of claims and only about $700 million of those claims have been paid thus far. Insurance companies do redline. It is very, very difficult for folks in the inner cities of this country to have access to insurance.

Because insurance companies redline, it's our feeling that if there are banks with outstanding records of service in other areas, that in allowing them to sell insurance, this would bring greater pressure to bear on insurance companies to reform their underwriting criteria to better enable banks to serve the communities which we represent. Our proposal is narrow and it serves a specific unmet need and it rewards those who serve the entire community.

I would close on this note, that I heard the Chairman's admonishment to Under Secretary Newman and to Comptroller Ludwig to expedite this matter, to move it forward. And Senator Dodd, you echoed that concern.

I would simply raise this plea. Appreciating your desire to expedite this issue around the expansion of bank powers, that I'd plead with you; don't let this train leave the station until the people we represent can be on board. And that means strengthening CRA.

The CHAIRMAN. Thank you very much. I appreciate your testimony.

Ms. Goodman, we'd like to hear from you now.

## STATEMENT OF SUSANNAH B. GOODMAN, POLICY ANALYST, PUBLIC CITIZEN, WASHINGTON, DC

Ms. GOODMAN. Good afternoon, Mr. Chairman, and Senator Dodd. Thank you very much for giving me this opportunity to testify today.

I'm a legislative advocate with Public Citizen's Congresswatch, which is a national consumer organization founded by Ralph Nader in 1971. I'm testifying today on behalf of Public Citizen, Consumers Union, ACORN, the National League of Cities, and the U.S. Conference of Mayors.

Collectively, we represent the interests of consumers, taxpayers, local communities, and especially low- and moderate-income communities.

You have made it very clear that you intend to move legislation on this issue by November. However, we have three serious questions about interstate branching that we feel must be addressed in any legislation before you move forward.

First, will interstate branching allow bit national banks to vacuum up deposits in local communities and then lend them elsewhere? Will it worsen problems of credit availability where they already exist?

Unfortunately, evidence strongly suggests that large banks with geographically diverse operations do drain deposits away from local communities. The House Banking Committee study on consolidation found that the 15 bank holding companies with substantial interstate operations they studied exhibited a serious lack of commitment to a portion of the communities they served.

Norwest drained funds in 8 of the 10 States in which it operated. BankAmerica drained funds in 3 of the States in which it operated. And Bank of Boston drained funds from 4 of the States in which it operated.

There is nothing in title 3 of S. 543 which adequately addresses this problem of draining. So we strongly urge the committee to pass legislation which would track commercial lending data along the lines of the disclosure requirements in the Home Mortgage Disclosure Act. Without this valuable information, regulators will have difficulty finding out if cries of a credit crunch are true and where capital has gone when it has disappeared from local communities.

I would like to draw the committee's attention to how useful this kind of data can be. I have here some beautiful color-coded maps. These maps have been derived from the Home Mortgage Disclosure Act data. If a picture paints 1,000 words, these maps tell it all.

Here's Detroit, Mr. Chairman. The colors tell you where Standard Federal makes home mortgage loans. And the lines tell you where minority populations over 25 percent live, right in here [indicating] and in here. It's all very clear. Standard Federal doesn't make many loans to minority communities, probably in violation of the Fair Lending laws.

The CHAIRMAN. Let me just interrupt you to say, as you may know, we're having a hearing on that very issue in this room tomorrow, to get at this question of the fairness of lending patterns.

Ms. GOODMAN. I appreciate that. I also have another map of New York. This is for Mr. D'Amato's benefit. This is Citibank. They are affirmative action lenders. Chase isn't.

These maps are easy to generate. Two guys in tee shirts generated these maps using the HMDA data and a computer down in a not-for-profit shop on P Street. But they are vital for the enforcement of CRA.

If this committee, in its wisdom, is going to go ahead and pass legislation allowing for consolidation in branching, we need the tools to show if banks are draining from communities and if there is discrimination in lending.

Our second concern is this—will interstate branching allow big banks to become larger and influence the price of loans and deposits?

In Senator Boxer's State of California, this is already a problem. More big banks control over 70 percent of the deposits. In California, the impact is clear. People pay more for loans than folks in the rest of the country and receive less for their savings.

I know that Senator Bryan, Senator Mack, and Senator Murray have expressed their reservations on this front last hearing and I will not ease their concerns when I tell them that the concentration limits in this bill, designed to prevent banks from controlling prices, are inadequate. The bill says that a bank can't have more than 25 percent of the deposits in a given State.

Well, some States are very big and some States are very little. And Adam Smith will tell you that prices for loans and prices for deposits are determined in markets, not in the geographic boundaries of a State.

If the committee truly wishes to address the anti-competitive effects of interstate branching, legislation should require an examination of all of the relevant criteria for determining anti-competitive behavior, including relevant geographic markets, different types of products, loans, lines of credit, as well as deposits.

Finally, I would also like to state that we have serious concerns about the safety and soundness of geographic diversification. Bank of New England, Citibank, Security Pacific, Seafirst, and Continental Illinois are examples of geographically diversified banking giants who were brought down by out-of-State loan activity and offshore lending activity.

Insolvent banks can cost taxpayers money. Undercapitalized banks drain money from small businesses and local communities to cover losses. Therefore, any interstate branching proposal should only allow well capitalized institutions to consolidate and branch.

I know you asked this question of the last two witnesses, but I would point out that this report that you commissioned from the GAO also supports this idea that banks that want to geographically diversify through interstate branching and consolidation be well capitalized and well managed.

Finally, we look forward to working with you and your staff in the coming weeks. We know that you want to go ahead with this and we hope that our concerns are addressed.

The CHAIRMAN. Well, they're certainly going to be very carefully considered, as are all the views being expressed today. I think the patterns of overlaying the market share of home purchase loans made by all lenders and then laying them in on this map and then scoring where the minority populations are, really does help drive home the dramatic difference that you can see in lending patterns of banks that are operating in the same area.

I take the data to be accurate as you've given it to us.

Ms. GOODMAN. It's the HMDA data.

The CHAIRMAN. But, I mean, I assume it's been scored properly on these sheets with the color coding. Making that assumption, which I assume to be the case, that is a very dramatic difference. I think it really underscores the point you make and I appreciate your going to the effort of getting that done.

Ms. GOODMAN. There's a study that came out, the not-for-profit group did a study using the HMDA data for, I think it was 16 major cities and looking at a large number of banks and mortgage company lenders.

They did just this—they have all the data in their computer. Generating the maps and reprinting them is expensive. But I've given them to your committee staff. I know Mark Hoffman has a set of the study and all of the maps. It's an example of how you can look at CRA in terms of performance, especially in the commercial lending area.

The CHAIRMAN. Well, I want to make sure that those are passed around. I want the staff on both sides to have a chance to see them. I think they're valuable.

Finally, Mr. Cassady, let me welcome you. You're here from Kentucky. I want to say that Senator Ford, from your State, was very active during our debate on this issue on the Senate floor and has worked closely with me and with this committee over a period of time on this question.

So there is an important background representational effort from your State on this issue and we're pleased to have you and we'd like your statement now.

**STATEMENT OF BALLARD W. CASSADY, JR., EXECUTIVE VICE PRESIDENT, KENTUCKY BANKERS ASSOCIATION, LOUISVILLE, KY**

Mr. CASSADY. Thank you, Mr. Chairman, Senator Dodd. I appreciate the opportunity to testify today on title 3 of S. 543. It's obviously an issue that bankers all across the country have very strong opinions about.

I serve as the executive director of the Kentucky Bankers Association and chairman-elect of the State Banking Association's group, which is an alliance of all 50-State association directors.

Thirty States were involved in a concentrated effort in 1991 to help pass the provisions contained in title 3 of S. 543.

The support from State banking organizations came from a wide variety of States with a diversity of banking structures. The support came from many small States, but also big States such as California, New York, and Texas. Our coalition included southern States, such as Alabama, Tennessee, and North Carolina, Midwestern States like Illinois and Missouri, and Northeastern States like Massachusetts and Connecticut, mid-Atlantic States like Maryland, and Western States such as Washington. I think we had a significant input from all elements of the industry and from every part of the country.

We have been encouraged by the position taken thus far by the Clinton administration supporting interstate banking reform, which includes the four principles of promoting efficiency and competition, protecting safety and soundness, meeting consumer and community needs, and respecting the interests of States.

In our view, the current Ford Bill, S. 810, is based upon each of these principles and most effectively satisfies the goals of the administration and is virtually identical to what the Senate passed in 1991 by passing title 3 of S. 543. Why did so many State bank associations support the Ford Amendment in 1991 and still support it through S. 810 today?

The answer is relatively simple—the Ford Amendment was the near-perfect compromise. Title 3 and S. 810 provide for nationwide interstate banking by acquisition. State law setting the age of banks to be acquired were respected. State laws regarding interstate banking and community reinvestment were respected. Consumer protection and fair lending would continue in effect.

This approach allows those institutions who sought growth through expansion the opportunity to do so by acquisition, then conversion, and at the same time protected the legitimate franchise interest of smaller community banks in two ways—first, they could just say no when an acquisition offer was made. Second, they

would be protected from de novo entry unless their State expressly opted in through legislation.

For those States who don't want any kind of interstate branching, they could opt by specifically passing legislation.

We believe that this bill strikes a balance where there is a need to update Federal States while still respecting the rights of States and the legitimate franchise interest of small, community-based lending institutions.

I could spend more of your time here today telling you about the economies of scale, the number of States already involved with interstate, or the inherent fairness contained in title 3 of S. 543 and S. 810. But you've already heard those numerous times before from the Treasury Department, the American Bankers Association, the Federal Reserve, and the Office of the Comptroller of the Currency.

I would rather address the fear that you often hear, that interstate banking and branching by acquisition would hurt smaller communities through loss of service. I cannot agree with this argument for two reasons.

First, consumers will go where they get the service and they'll take their money with them. Innovation and market void penetration were invented by Americans. Therefore, I believe that if the larger banks are not servicing the small communities, you will see a proliferation of new bank charters to fill that service void.

Second, as pointed out by Comptroller Ludwig, successful banks have traditionally been those that best meet the needs of the market they serve. Large banks have adapted, somewhat, but small community banks have excelled at personalized service when needed, especially in loaning to small business. That is where the knowledge of borrowers and local credit conditions are major factors and most likely to be possessed by the smaller community bank.

This statement is contingent on the Government making new charters accessible under reasonable guidelines and also contingent upon the Government realizing the different regulatory needs between the two types of institutions.

For example, I believe the Community Reinvestment Act requirements and guidelines should be much different for rural communities than they are for urban areas.

I've attached for your review exhibit A, which outlines the essential traits of interstate banking reform that are solved by the majority of State banking associations. Senate Bill 810 is the best compromise available.

In addition, what is of particular interest to us was Governor LaWare's testimony concerning interstate banking and branching before this committee on October 5, 1993, in essence, calling for parity for foreign banks in their interstate operations.

As a former small town bank president and a former commissioner of banking for Kentucky, I can only say that I wish foreign banks had parity of treatment with U.S. banks. Currently, they receive treatment more preferential than national treatment.

Foreign banks operate 98 separately chartered U.S. bank subsidiaries and they also operate 868 full-service branches, agencies, and representative loan offices. They have 15 international vehicles, known as Edge Act Corporations, and eight business loan of-

fices chartered in New York. In all, 302 banks from 62 countries operate banking offices here with projected assets of $899 billion.

They make almost 36 percent of all commercial and industrial loans, 18½ percent of commercial real estate loans, and 21 percent of all U.S. banking assets. That is, until you add in and take into consideration their offshore branches, principally in the Bahamas and the Cayman Islands.

As of January, 1993, the Federal Reserve, on behalf of the Federal Financial Institutions Examination Council, has been gathering information on the offshore activities of non-U.S. banks that have related U.S. offices.

The new data shows that as of March, 1993, assets and liabilities of offshore, non-U.S. bank branches amounted to $379 billion. Almost two thirds of that, or $219 billion, of the total reported assets were claims on U.S. residents. If you add the new data on offshore activities to existing data on branches and agencies, you increase total U.S. assets held by foreign banks to over $1 trillion, or 25 percent of America's total banking assets.

Their share of commercial and industrial loans increases from 36 percent to almost 42 percent. Their share of commercial real estate loans increases from 18½ percent to 21 percent. This alone does not concern you. Foreign banks' growth in the United States over the last 2 years has averaged annually 6½ percent growth, compared to U.S. banks' domestic growth of less than 1 percent. Why and how has this kind of dominance been able to take place over U.S. banks in this country?

Quite simply, foreign banks have major competitive advantages in pricing loans and deposits over U.S. banks. The cost of capital to U.S. banks has increased significantly through compliance with numerous regulations not imposed on foreign banks. Foreign banks conduct most of their activities in this country through branches of their main banks headquartered abroad. These branches do not pay deposit insurance premiums. They are not subjected nor involved in any Community Reinvestment Act requirements, nor are they subject to a host of consumer statutes like those American banks are subjected to.

Last week, you heard testimony from the Treasury Department concerning the future efforts to ensure that U.S. banks operating abroad would have equal access to foreign markets.

As this committee knows, Chairman Riegle and Senator D'Amato have long advocated such a stance by the Treasury Department. I, too, applaud this long overdue initiative. However, I would suggest that this committee also examine why we're giving foreign banks operating in this country advantages over U.S. banks, thus aiding their ability to expand their U.S. market share. Also, why is the Federal Reserve talking about expanding foreign bank privileges while ignoring the competitive advantage they already enjoy in this market?

In conclusion, I would like to say that we support S. 810, which contains all of title 3 of S. 543, which passed the Senate in 1991, and would suggest that this committee go one step further and make sure that we stop giving foreign banks competitive advantages in our market.

The CHAIRMAN. Thank you very much. Let me just say, Mr. Cassady, starting with you, I think that's very valuable testimony and I appreciate the effort that you've gone to to aggregate these statistics. Those percentages of change in market share, I think, are really quite dramatic.

I think it does tell a very important story of damage being done to our domestic banking industry by a competitive inequity here that usually isn't detected on the radar screen.

I think we need to deal with that. So I thank you for your work. I'm not going to take you back through it because I think your statements were very declarative in terms of the fact that you're convinced this does give foreign banks advantages in both attracting deposits and underpricing American banks for the more highly rated borrowers in this country.

Let me ask you, Rev. Stith. You commented on the difficulty of inner-city and low-income community people having access to banking services and that's a very deep concern of mine as well. I appreciate, as well, your comment about Comptroller Ludwig having conviction in this area that we haven't always seen. I think we're very fortunate to have somebody there who doesn't just understand this issue in the abstract, but who feels it and comes off a base of feeling about it.

This committee feels some pride in the fact we had something to do with making sure that that vacancy was open and he now fills it. So I speak with some particular pride about that.

Would it be fair for me to conclude from what you say that if we allow banks in low-income communities to sell insurance in those communities, that those banks are more likely to come on in and open up shop and be available to meet credit needs and to provide services to inner-city people that would benefit those communities?

Rev. STITH. I think in part, Mr. Chairman, that might be the effect. But our experience has been that the more critical factor is those communities where banks have really been pushed to comply with CRA.

In Massachusetts, for example, and in Boston, more precisely, where there has been a lot of activity around CRA compliance, we've seen some significant and, in some cases, dramatic change in the way banks have gone about doing business.

I would cite the Bank of Boston. In 1992, they did three times as much home mortgage lending to African-Americans than they did in 1991, and their declination rate for whites was actually higher than it was for African-Americans in 1992.

So, while I think to allow them to sell insurance would in part be an impetus to better serve our communities, I think the greater factor is strengthening CRA.

I would simply add, and this would reference a point that was made by Senator Moseley-Braun before she left, that it's important. Given the diminishing share of the financial services industry that banks now have, it's important that we look at pushing other segments of that industry on the issues like community reinvestment. And our contention is that for banks that have demonstrated that they not only know how to talk the talk around CRA, but are able to walk the walk, that that will help bring some pressure to bear

to get insurance companies to step up to the bar in an appropriate fashion.

The CHAIRMAN. Senator Dodd.

Senator DODD. Just to pick up on that point, just for clarification purposes, and I agree with you on CRA, I don't know if anyone's talking about banks engaging in the underwriting insurance. You're talking about agency activities.

Rev. STITH. That's right.

Senator DODD. So the fact that insurance companies have not been as forthcoming and are engaging in redlining activities, as you point out, I think is a worthwhile point. But what's being discussed about insurance agency activities on the part of banks wouldn't necessarily change the companies.

Rev. STITH. Not necessarily, which is why I said I think that the real weight belongs on the side of CRA. Again, one of the reasons why I said pressure rather than put banks in a competitive position, Senator, is precisely relevant to the point that you're making, that they won't be in the business of underwriting, but in the business of selling. And because they're there and they want to move product, then that might have an effect of moving insurance companies to be more sensitive.

Senator DODD. You wouldn't necessarily be in favor, however, if that were to be allowed, that those banks then be allowed to sell insurance anywhere they wanted, nationwide, as a result of having a presence in hard-pressed inner-city areas where competition didn't exist.

Rev. STITH. Precisely.

Senator DODD. I just wanted to establish that.

Rev. STITH. We're talking about, I think, some pretty big, some pretty important structural changes, some big picture issues. But before we complete the big picture, we have to make sure that they have demonstrated the capacity to deal with the details of getting the services and capital to people who have been most starved in that regard.

Senator DODD. Let me just go down the table here. I heard, and I took notes on what everybody has said and have the testimony, but let me get—with all of the caveats that have been mentioned here, taking in that some of them are conflicting, but the basic question—are you for interstate banking or are you against it? And I'm taking into consideration your caveats.

Let's start with you, Ms. Walker.

Ms. WALKER. Senator, we're trying to facilitate it according to the States meeting the needs of their communities and consumers. That's why we're here, to make it work.

Senator DODD. The bottom line is you would support interstate banking.

Ms. WALKER. Yes, with States' rights preserved.

Senator DODD. I understand. Gerry.

Mr. NOONAN. Yes, we support interstate.

Rev. STITH. Our position is that there are some realities, like consolidation, that are driving us in that direction, but that we need to proceed with great caution and make sure that issues like community reinvestment get dealt with substantially. Without

that, I think that the Congress, and the Senate in particular, needs to be in the vanguard of holding it up.

Ms. GOODMAN. I'm speaking on behalf of a broad coalition.

Senator DODD. I know you are. I was amazed at the many different organizations you're here for.

Ms. GOODMAN. We're difficult to convene. I really can't say yes or no at this point without——

Senator DODD. You probably can't say both yes and no.

[Laughter.]

Ms. GOODMAN. Either/or. But I would urge you to look at our recommendations.

Mr. CASSADY. Senator, with all the caveats mentioned.

Senator DODD. Yes. Well, I must tell you, I don't get, what I sense, and I appreciate all the various comments, I hear from—and Gerry Noonan, I understand you're representing Connecticut Bankers here, but frankly, I don't hear a great deal of enthusiasm any more from the American Bankers Association over this. I hear a lot of concerns being represented by everyone else at the table.

Mr. Chairman, maybe interstate banking, maybe we should just abandon the thing. I've always believed in it, thought it was worthwhile. But I don't hear anybody tell us that they care much about it, frankly.

If that's the case, then maybe we'll just move on to some other issue. I need to know that at least we're doing the right thing. I think we're going in the right direction. And if what the collective judgment is that, frankly, you can leave this thing up to the courts and wander on the way it is, we've got a lot of work to do and there are other things that we can focus our attention on.

If that's the collective judgment, I think we need to make a cut at whether or not this is something we really ought to pursue.

The administration doesn't seem to care a whole hell of a lot about it. No one else does. I think that there's a mistake in that, I would tell you. But I also know how difficult it is to get something done when there's little or no interest.

I frankly would go on record as saying I think it's an unmitigated disaster if we don't get something done for this country. But if there's little or no enthusiasm for it, then I say we'll continue to wobble along here the way we are and move on to other issues. Any comment on that?

Mr. NOONAN. Senator, I would only comment that, again, there are some very large institutions that this would be a tremendous cost-saving for and they feel that they could pass this on to the consumer, et cetera.

Senator DODD. Couple.

Mr. NOONAN. But speaking for Connecticut, certainly not the Nation, that we have so many competitive problems in the banking industry to face from a business sense, from competitors that we feel do our business, or what was traditionally considered our business, and do not have any of the other burdens and responsibilities that we tackle, not always smiling and laughing and happy, but I think we're stepping up to the plate and maybe we should have done it sooner. But those are the issues that we really grapple with. Will we be 10 years from now 50 percent less of the financial

services community, just as we are 50 percent less than we were 20 years ago?

Those are really the issues. Interstate branching will come. Things like that will come. And I think that, yes, you have made a point, that with all the things we've got to worry about in our industry, you've got a lot on your plate. I wouldn't die for this one.

Senator DODD. We'll just deal with the insurance issue, maybe. Just deal with that one.

Ms. WALKER. If I may add, Senator, I firmly believe that if interstate branching is rammed down the throats of States, I think there could be some very serious and adverse consequences, though I'm not as convinced that there are as many benefits that have been touted. But to the extent that it has to come, I think it has to be done in a very high-risk management way.

Rev. STITH. Senator, I'd say that, whether it's interstate branching or not, that there are two fundamental issues. One is how do we keep the banking industry in this country viable and profitable? And the other side of that is where the rubber meets the road, and that is how do you get capital from the bank to an individual family or to a community or to a business?

Again, it's our position that if we begin to take community reinvestment seriously, I think we'll be able to accomplish a lot that will make this industry work.

Senator DODD. I think you're probably right on that. I think we ought to put more attention on that, maybe, and deal with the annuities and the insurance issue.

Yes.

Ms. GOODMAN. I would echo that concern. I think it would be great if you would move forward on the commercial lending data proposal.

Senator DODD. Mr. Cassady.

Mr. CASSADY. I agree with Mr. Noonan. I think that interstate banking and interstate branching is almost inevitable. Eventually, it's going on State by State. I think that to do that in this body by rolling back some authority that they currently have, such as insurance, I think that in that case, no, I sure wouldn't trade the two.

As far as community reinvestment and interstate banking is concerned, I think there needs to be some attention given to the fact that small community banks don't operate the same as large urban banks.

I've got a bank in my State that's $1 million in total assets in a town of a hundred people. I can't imagine how they comply with all the CRA stuff. I don't even know if they are. I suppose they are. I don't see their name in the newspaper. But if they don't lend to every creditworthy customer in that community, they're out of business.

So there are certain entities out there that shouldn't be subjected to some of the wide range of things. And on the foreign bank issue, I think this is something that this committee really needs to take a look at, the inequities there, prior to including them in some wisp of the brush that would be taken in interstate banking.

Senator DODD. Yes.

The CHAIRMAN. Well, thank you all very much. I appreciate your testimony. It's helpful to us. We'll take full account of it.

The committee stands in recess.

[Whereupon, at 12:53 p.m., the committee was recessed.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

## STATEMENT OF SENATOR ALFONSE M. D'AMATO

Mr. Chairman, I commend you for convening today's hearing to discuss interstate banking and branching. I look forward to hearing from the administration and the banking industry representatives. I am particularly eager to hear the administration explain its "go slow" approach to achieving meaningful national interstate banking.

As Comptroller Ludwig and Under Secretary Newman point out in their testimony, permitting interstate banking and branching would greatly benefit banks and the banking system. Banks would be able to streamline their operations, diversify risk and become more efficient overall. The cost saving benefits of consolidation would also be passed on to consumers through the pricing of financial products and return on savings.

Further, loosening interstate banking and branching restrictions could increase the availability of credit as banks spend less money maintaining separately run subsidiaries.

Technology has made it increasingly unrealistic to constrain bank activities within tightly drawn geographic borders. The United States is the leading force in financial innovation, but in certain States a bank can only conduct business within the confines of that State. This has become increasingly inconvenient for many consumers and increasingly costly for many banks.

Restricting interstate banking and branching simply does not make sense.

Although 33 States have passed laws that allow nationwide interstate banking and 14 States allow regional banking, legislation to permit full-scale interstate banking and branching has yet to pass both Houses of Congress.

I look forward to working with Members of this committee to enact a bill permitting interstate banking.

Thank you, Mr. Chairman.

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## STATEMENT OF SENATOR CHRISTOPHER J. DODD

Thank you Mr. Chairman. I want to commend you for holding today's hearing—the last of two important hearings—designed to address interstate banking and branching and insurance issues. I am pleased to see our distinguished panel of witnesses today. I am especially pleased to welcome Gerry Noonan, president of the Banks' Association of Connecticut to our panel of distinguished witnesses.

### Administration's Support

Since our last hearing, I am pleased that the administration has outlined its position on interstate banking. In his recent speech delineating the administration's banking priorities, Secretary Bentsen expressed his support for interstate banking and branching as a means to "eliminate roadblocks and make it less expensive and cumbersome for our banks to operate across State lines." Under Secretary Newman and Comptroller Ludwig have since articulated in great detail the reasons for the administration's support of interstate branching. I regret that their conclusions, thus far, have not yet justified the strength of their support for full interstate branching. But, I am hopeful that the administration's position will become clearer and more consistent as we move ahead.

### Interstate Benefits—Focusing on Consumer Benefits

I believe that full interstate branching would streamline administration, improve bank efficiencies, ease regional economic slumps, boost consumer conveniences, ameliorate the impact of future credit crunches, and enhance the safety and soundness of the banking industry.

I've discussed many of the benefits of interstate banking and branching in much greater detail before. So I won't go into all of the reasons for my support today. I would, however, like to touch briefly on one area which is frequently underplayed: the benefits to consumers. Secretary Bentsen recently commented: "In the age of fiber optics, when I can go to a machine on the streets of virtually any capital in the world and get cash with my bank card, not being able to make a deposit at my own bank just because that branch is in another State is like requiring that the space shuttle stay within the school-zone speed limit."

For those who believe that the number of individuals who would benefit from these conveniences is small, recent statistics reveal otherwise. The Census Bureau reports that 60 million Americans live in metropolitan areas that cross State lines, 4 million Americans commute interstate each day, and 493 million trips are taken by Americans each year across regions.

In addition to increased convenience, consumers will benefit from the savings achieved through the breakdown of market barriers and through increased competition. Recent studies have revealed that bank performance improves with increased market entry, and lower prices, higher returns, and greater convenience results.

THE DODD INTERSTATE BILL

It is critical that we establish a sensible and consistent interstate banking and branching approach, such as that outlined in S. 371, legislation I introduced with my colleagues Senator D'Amato and Senator Kerry.

Our bill, S. 371, would permit bank holding companies to acquire, one year after enactment, existing banks anywhere in the United States. Eighteen months after enactment, a bank holding company operating subsidiaries across State lines could consolidate them into a single bank. Three years after enactment banks would be able to branch interstate nationwide. States could opt-out of branching if they choose—but banks located in States that opt-out would not be permitted to branch interstate.

Our bill would promote efficiency and competition while providing safeguards against bank concentration. It would protect safety and soundness and prohibit undercapitalized institutions from participating in interstate branching. It would respect the interests of States by requiring branches to abide by all applicable State laws including consumer protection and fair lending. And, it would meet community needs by maintaining Community Reinvestment Act requirements.

INSURANCE PROVISIONS

At our last hearing, I encouraged the banking industry and the insurance agents to work together to reach a mutually beneficial agreement on interstate and insurance issues. I regret that this offer was rejected by many members of the banking industry. I plan, however, to offer an insurance amendment at the Banking Committee's mark-up on November 18, if, in fact, we're able to have a mark-up on that date.

This committee and the Senate have dealt with the interstate and insurance issues in the past and we've had trouble in resolving these issues. But, the concerns are not going away.

My amendment will be reasonable. It will include consumer protections, it will clarify Congress' intent on the towns of 5,000 issue, and it will prohibit the wholesale creation of new powers by the Office of the Comptroller of the Currency. It will not, however, include provisions closing the Delaware loophole which were previously approved by this committee and by the full Senate in 1991.

Without congressional action, the regulators and the courts have made major policy decisions in the banking and insurance arenas by expanding loopholes far beyond their original scope and intent. Even if you agree with the ultimate result of these policies, you have to believe that it doesn't make any sense to accomplish them in such a manner.

In its decision earlier this year, the D.C. Circuit Court invited the Congress to clarify the towns of 5,000 issue stating: "When time and technology open up a loophole, it's up to Congress to decide whether it should be plugged and how." I believe that it is our responsibility to resolve this and other issues related to the sale of insurance by national banks now.

Thank you again, Mr. Chairman. I look forward to working with you and our colleagues to move an interstate and insurance bill later this month. And, I look forward to hearing the comments of our witnesses today.

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## STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Mr. Chairman, the issues before the committee this morning are important ones. As you know much better than I, our economy is changing rapidly, and those changes are responsible for major, ongoing changes in our financial services industry.

We are here to look at interstate branching issues and questions surrounding the sale of insurance by national banks. I think that our priority, as we consider what steps to take in each of these areas, must be to put the interests of the users of our financial services system first.

What that means is that we need to consider the impact of proposed changes on consumers, on communities, on businesses. We need to look at what changes in Federal law in these areas will mean to their access to financial services, and whether it will affect the quality and price of the services they are offered.

The banking system is particularly important to small- and medium-sized businesses, as well as to many consumers and communities. We need to understand how they will be impacted, keeping in mind that banks are steadily losing market share to other kinds of financial institutions.

That fact is important because it reminds us that change does not stop if we do not address the issues. Change is ongoing, and the structure of Federal laws does help shape—some might say warp—the changes as they apply to our financial services system.

There is a lot at stake here. The decisions we make will have a significant impact on our economic future, and on the ability of our economy to create new jobs. I congratulate you, Mr. Chairman, for calling this hearing. I look forward to hearing the testimony of the distinguished witnesses before us today, and to working with them, with you, Mr. Chairman, and all interested parties on an appropriate, forward-looking response to the changes sweeping our economy, so that our financial services system can better meet the needs of the consumers, businesses, communities and others that depend on it.

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## STATEMENT OF FRANK N. NEWMAN

UNDER SECRETARY OF THE TREASURY

NOVEMBER 2, 1993

Chairman Riegle, Senator D'Amato, and Members of the committee, I am pleased to be here today at your request to discuss the administration's views on interstate banking and bank insurance activities, two topics we believe are conceptually distinct and should be dealt with separately.

I am not here today to call for precipitous action in either area. As Secretary Bentsen declared last week, "this administration will take a deliberate, disciplined approach that will produce more and better results over time. We will focus on achievable goals and pick targets carefully. We will build consensus, issue by issue. And we will listen seriously to the concerns of all those with a genuine public policy interest in an issue." The Secretary called for quick action on three bills already before the Congress. These bills involve RTC funding, community development financial institutions, and fair trade in financial services.

### I. REASONS TO RELAX GEOGRAPHIC RESTRICTIONS

U.S. geographic restrictions are unique among the industrialized nations of the world, and many observers consider them among the least defensible of our banking laws. The administration supports the idea of reducing these restrictions. In my testimony today I will discuss the reasons behind our thinking, analyze the concerns most commonly raised, and provide the administration's views on key issues.

Geographic restrictions on commercial banks originated in the earliest days of American banking to protect banks from competition and preserve local markets for local banks. However, these restrictions warrant reassessment because financial markets and institutions, and the economy itself, have evolved dramatically since then.

We find the current framework of geographic restrictions no longer appropriate, for several reasons. First, modern banks operate beyond local markets, and they compete with non-bank institutions that face no similar geographic restrictions. Second, the States themselves have relaxed geographic barriers. Third, removing these restrictions could improve the safety and soundness of the banking system. Fourth, the public could benefit from greater competition, improved bank performance, and greater customer convenience. Finally, removing geographic restrictions would let banks structure themselves more efficiently, which could ultimately permit banks to make more credit available to businesses and individuals.

*Current Operating Realities*

Banking organizations can no longer be defined in terms of the limited services and facilities considered appropriate in past generations. New realities are evident on both sides of the banking balance sheet. For example, on the liability side of the balance sheet, banks fund themselves not only with traditional (local) retail deposits, but also with large negotiable certificates of deposit, foreign deposits, Eurodollar borrowings, Fed funds, repurchase agreements, and debt and equity issues, among others. These funding transactions can involve local, regional, national, and international financial markets.

On the asset side, large banks have for many years reached for business opportunities beyond local markets. Real estate loans, commercial loans, foreign government loans, securitized loans, and various types of loan participations typically require involvement in non-local markets. The same is true of such other services as money management, cash management, electronic funds transfers, private placements, credit card distributions, foreign exchange dealing, and various risk management activities.

Further, geographic restrictions keyed to local markets have proven porous. They apply to brick-and-mortar branches but not to loan productions offices, Edge Act corporations, or mortgage finance, consumer finance, or securities brokerage subsidiaries—which banks and bank holding companies may establish anywhere, without regard to State boundaries or intrastate branching restrictions. Moreover, numerous bank holding companies have used grandfather rights, emergency acquisitions, and evolving State laws to establish extensive, though unwieldy interstate banking networks.

*Non-Bank Institutions.* Many non-bank financial institutions offer products that compete directly with bank services. Yet these non-banks can operate more efficiently because they face no geographic restrictions. Federally chartered thrift institutions can branch nationwide. Federal credit unions can do likewise, so long as their members share the requisite common bond. Mutual funds, many of which offer check-writing and other consumer conveniences, have become the most notable substitute for insured deposits. Securities firms also compete for savers' funds by offering cash management accounts, with check-writing and credit card features, through large networks of geographically dispersed offices. Insurance companies provide a bank-like savings service nationwide through insurance policies with redeemable cash value; and they compete directly with banks in making large commercial and real estate loans. Other major competitors that operate free from geographic restrictions include consumer, business, and sales finance companies; mortgage companies; the captive finance firms of automobile and appliance manufacturers; and retail credit grantors.

On balance, geographic restrictions have outlived their usefulness and no longer reflect bank practice or competition. Rather, they require banks to organize themselves in cumbersome and inefficient ways to compete.

*The Trend Among the States*

The States have already come to recognize the inefficiencies of geographic restrictions. For example, as recently as 1980, over half of the States retained highly restrictive intrastate branching rules. Since 1980, however, branching rules have loosened considerably. Today, 46 States (plus the District of Columbia) permit Statewide branching. Four States continue with limited branching, and no State retains unit banking—the old policy of allowing banks to have only one office.

Interstate banking, in which bank holding companies own banks in different States, has developed even more dramatically. From the time of the Bank Holding Company Act of 1956 to the mid-1980s, interstate banking barely existed, and then only through grandfathering or other limited exceptions. But once the Supreme Court upheld New England's regional interstate banking compact in 1985, the States rapidly implemented interstate banking. Currently, all States but Hawaii allow out-of-State bank holding companies to acquire banks within the State. However, these laws vary considerably from State to State. Consequently, we lack a uniform, efficient, and truly national approach to interstate banking.

Several factors help to explain the 1980s trend toward easing geographic restrictions on banks. First, the States sought to attract and pool capital to support their economic growth and development. Second, the Federal Government as well as the States needed to facilitate the resolution of troubled banks and thrifts by permitting acquisitions by out-of-State institutions. And third, banks made an increasingly cogent case for competitive equity vis-a-vis their non-bank competitors.

*Safety and Soundness*

Relaxing geographic restrictions will tend to promote a safer and sounder banking system. Allowing banks to diversify their assets geographically allows them to diversify their income stream and make it more stable than that from any one geographic area. Geographically limited banks have earnings more susceptible to the vagaries of local market cycles, which renders such banks more likely to fail. Indeed, regional economic downturns figured prominently among the causes of many of the bank failures of the 1980s.

Geographic diversification also facilitates developing a strong retail deposit base, which represents additional protection against failure. Historically, banks heavily dependent on purchased funds have shown heightened vulnerability to rapid deposit

outflows. Banks with a large, geographically diverse retail deposit base have been better able to avoid or withstand liquidity problems.

Finally, to the extent that interstate consolidation reduces bank operating costs, it would help banks build or maintain capital, directly contributing to overall safety and soundness.

*Efficiency and Cost Savings*

Many banks and bank analysts argue that consolidating banks into branches across State lines would yield major cost savings, as banks eliminated duplicative functions and reduced expenses. While the extent of the savings may vary from one bank to another, we are convinced that many banks can realize very substantial efficiencies. Moreover, the fact that savings may vary across banks in no way warrants denying banks an opportunity to realize these savings.

II. CONCERNS RAISED BY GEOGRAPHIC LIBERALIZATION

A number of concerns are commonly raised about geographic liberalization. Included among these are that liberalization might: (1) lead to a decline in the number of small banks; (2) result in an excessive concentration of resources; (3) siphon credit from local communities; and (4) damage the dual banking system. I would like to discuss each of these concerns in turn.

*Decline in Small Banks*

Among the most frequently voiced concerns is that interstate branching will inevitably reduce the number of small banks: large institutions will enter local markets and drive out, or buy up, all the small community banks. However, ample evidence indicates that this outcome is not inevitable or even likely. For example, small banks have continued to prosper in States, such as New York, that over the years significantly reduced intra- and interstate geographic restrictions.

Even in States that have long had liberal branching laws, small banks prosper and compete successfully with large banks. For example, in my home State of California, which has had unrestricted branching since the early 1900s, hundreds of small banks, as well as many thrifts and credit unions, operate alongside large banking organizations with their far-reaching branch networks. Other States that have long permitted extensive branching, such as New Jersey and North Carolina, also have strong small bank communities.

Thus, fears that relaxing geographic restrictions will undermine the viability of small banks and the maintenance of competition are, we believe, ill-founded. Over the years small banks have been among the most profitable and best-capitalized banks in the Nation. Well-managed small banks that know and meet their customers' needs can flourish without geographic barriers to entry. Moreover, the availability of new bank charters will help to maintain a reasonable balance between large bank organizations and small, independent institutions.

*Concentration of Resources*

A longstanding concern about removing geographic restrictions involves the potential concentration of banking resources and its effects on competition. While this concern cannot be dismissed lightly, new measures to limit concentration are unnecessary. Despite progressive consolidation at the State and national levels, the level of concentration in local urban and rural markets has remained virtually unchanged for almost two decades.

Indeed, we believe the issue of market share limits (and other proposed concentration safeguards) demands further analysis. As I discussed earlier, modern banks engage in a wide variety of activities in competition with a wide variety of non-bank financial intermediaries. Because of this, determining the appropriate limits on market share, or even the proper definition of the market, can be complicated. Among other things, serious questions would need to be answered involving the size of market, the range of institutions covered, and the degree of uniformity of limits across different jurisdictions. For example, savers can place their funds in banks, thrifts, credit unions, mutual funds, and other entities, including money-market funds with check-writing capabilities. Without good answers to the above questions, market share limits would not yield the intended effect. For these reasons, we believe it is better to continue to rely on detailed reviews of specific merger and acquisition transactions by the appropriate Federal agencies and the Department of Justice, in order to assure competitive markets.

*Local Reinvestment*

Another concern raised is that interstate branching may undermine the intent of the Community Reinvestment Act of 1977, and siphon funds from local communities. But interstate branching legislation need not alter the CRA: all existing re-

quirements for community reinvestment will remain intact and serve to ensure that banks meet local credit obligations. Moreover, we find no firm foundation for asserting that branch banking is more likely than other banking structures to divert funds from local communities. On the contrary, the historical evidence shows generally higher bank loan-to-asset and loan-to-deposit ratios in jurisdictions with more liberal branching.

Indeed, the propensity to export capital or lend locally is unrelated to bank branching structure. For example, a community bank not wishing to lend locally—or not finding sufficient local loan demand—can already sell Fed funds upstream to a correspondent bank, buy securities, or participate in loans originated by banks located elsewhere.

Finally, the siphoning argument amounts to a double-edged sword: a bank can also inject credit into an area, and bring funds into local communities. This is among the reasons why States have liberalized their branching and interstate banking laws. That is, broader geographic expansion authority can produce more efficient credit distribution, including a greater flow of funds to communities with the greatest credit demand.

*The Dual Banking System*

An often-raised concern is that interstate branching might damage the dual banking system, but this should not happen. Current legislative proposals for interstate branching generally preserve States' authority to determine banking structure and otherwise regulate financial institutions within their jurisdiction. Under these proposals States would retain their current authority to control branching within their borders by national and State banks, and to limit interstate branching by their own State banks. These proposals also permit States to impose on banks and branches within their borders certain State laws regarding fair lending practices, unsafe and unsound banking practices, and community reinvestment requirements (as if the bank were headquartered in the host State).

III. Administration Views on Geographic Restrictions

As I mentioned earlier, the administration supports the idea of further relaxing geographic restrictions. But in that process, we believe that certain principles should be followed. The principles include: (1) promoting efficiency and competition; (2) protecting safety and soundness; (3) meeting consumer and community needs; and (4) respecting the interests of the States. Additionally, we believe that any legislation in this Congress to relax geographic restrictions should be kept separate from other issues so that it can be considered on its own merits.

One approach to reducing geographic restrictions that would accord with these principles would be for Congress to:

- permit any bank holding company to acquire a bank in any other State, unless that State opted-out of such interstate acquisitions;
- permit the out-of-State holding company to consolidate any subsidiary bank with any of the holding company's other subsidiary banks, and thus convert the bank's offices into branches of the consolidated bank, unless the State opted-out of such interstate consolidations; and
- permit the consolidated bank to branch within the State to the same extent as a State bank chartered in that State.

Such legislation could take effect some time (e.g., 18 months) after enactment. States could opt-out at any time after enactment. If a State did opt-out of interstate acquisitions or consolidations, it would seem only fair that its bank holding companies would be ineligible to engage in such transactions themselves. In any event, opting-out would not invalidate any acquisition or consolidation that was lawful when made.

This approach would permit banking organizations to structure themselves more efficiently and thus reduce their operating costs. And it would benefit consumers and businesses through lower costs and greater convenience in the market for financial services. Consolidating a bank holding company's interstate banks would not change the amount of banking assets under common control, and should raise no new issues regarding concentration. The acquisition of new offices would be subject to concentration and competitive effects analysis by Federal agencies, as is currently the case.

Any relaxation of geographic restrictions should not be allowed to undermine banks' obligation to serve their local communities. In this respect, it is useful to emphasize that all existing CRA requirements will remain in effect. A related concern is that interstate consolidation of banks into branch systems might reduce the information available on banks in their communities. We believe that an appropriate response to this concern is a separate CRA evaluation for each metropolitan area; this

matter will be addressed in the new performance-based CRA approach that the regulatory agencies are currently developing.

Finally, any relaxation of geographic restrictions should accord foreign banks national treatment—the same competitive opportunities as U.S. banks.

In sum, we believe relaxing current geographic restrictions should yield a number of benefits. Banks could benefit from greater efficiency. Businesses and consumers could benefit from less costly financial services, and greater locational and product convenience. And the banking system could benefit from improved safety and soundness.

## IV. Insurance Activities

When considering appropriate activities for commercial banks, our two standard questions stand out in importance. First, does the activity contribute to the safety and soundness of the banking system? Second, does it on balance offer benefits to consumers? Sale of insurance by banks under current law, conducted appropriately, can meet these tests.

### *Safety and Soundness*

Recent experience demonstrates that the banking industry is not immune to economic difficulties. In fact, the industry has suffered long term decline in the face of stiff competition from many less-regulated providers of financial services. On the asset side of the balance sheet, loans have been lost to the commercial paper market, commercial finance companies, insurance companies, and other competitors. On the liability side, funds have flowed in large amounts from bank deposits to mutual funds and other financial assets provided by competing firms.

Thus, in spite of today's healthy profits, we cannot be indifferent to the long-term strength of the banking industry. For many consumers, businesses, and communities it remains the most important source of financial services. Banks provide such basic financial services as savings and transaction accounts, bill paying, and check cashing, which many individuals and businesses critically need. Banks extend loans to small businesses that may otherwise lack access to capital. And they generally support local communities in ways foreign to more specialized financial intermediaries.

We believe that national banks' insurance activities under current law pose no safety and soundness problems. In selling insurance, banks do not assume the risk of insurance underwriters, and banks' capital remains unimpaired. This stands in sharp contrast to bank loans, where the bank typically assumes the entire risk of default. Moreover, insurance sales can provide banks with the benefits of diversification. Such diversification tends to increase and stabilize overall bank earnings, and thus contributes to bank safety and soundness. Such stability can help enable banks to provide more credit to borrowers, even in hard times.

### *Consumer Benefits*

We believe bank sales of insurance can benefit consumers through lower prices and greater convenience. In particular, a wider variety of bank products and services allows banks to reduce overhead costs per unit sold. Insurance sales by banks, appropriately conducted, can also benefit consumers by reducing the time and effort expended in purchasing insurance. Bank facilities are conveniently located for most consumers, and banks could provide one-stop shopping for both banking and insurance needs.

Greater convenience may be most important to consumers and small businesses in remote areas or low-income communities, where the availability of financial services may be more limited. This is one reason why current law permits national banks to engage in general insurance sales in small towns. Another reason is that the opportunity for such sales can encourage banks to locate or expand their operations in small towns. For similar reasons, we believe it may make sense to explore the idea of permitting national banks to sell insurance in low-income, inner-city neighborhoods.

On balance, we believe that selling insurance entails minimal risk for banks. In addition, we believe that consumers may benefit through increased services, greater convenience, and potentially lower insurance prices.

### *S. 543*

We are concerned that certain of S. 543's insurance provisions may move us in the wrong direction. They would significantly restrict banks' authority to sell insurance from small towns. Today national banks located in small towns can sell insurance nationwide. S. 543 would generally confine that authority to the town and its contiguous rural areas. Such a curtailment may be enough to diminish many banks' economic incentives to locate in and provide insurance services to such areas.

Another provision of S. 543 would suspend the Comptroller of the Currency's authority under national banking law to approve bank insurance activities that are incidental to the business of banking. We see no need for this provision. Banks could lose opportunities to diversify services and stabilize earnings, contributing to banking system weakness. And consumers could lose the price, availability, and convenience benefits of more competitive insurance markets.

For these reasons, we do not believe that the current insurance activities of national banks should be limited.

V. CONCLUSION

Mr. Chairman, I commend you and the other Members of the committee for the seriousness and commitment you bring to these important issues. We very much look forward to working with you.

I would be pleased to respond to any questions you might have.

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## PREPARED STATEMENT OF EUGENE A. LUDWIG

COMPTROLLER OF THE CURRENCY

NOVEMBER 2, 1993

SUMMARY

Mr. Chairman and Members of the committee, I appreciate this opportunity to testify on interstate branching. Markets for financial services have no natural geographic boundaries. Yet, banking firms are, for the most part, required to do business through separately chartered subsidiary banks in each State in which they operate. This inconveniences customers who bank in more than one State and drives up the cost of banking services.

Permitting banks to operate interstate branching networks should help improve the safety and soundness of the banking system and it should help banking companies provide more convenient and cost-effective service to their customers.

Although interstate branching is virtually restricted by the McFadden Act, Federal law does allow for interstate banking. Under the Douglas Amendment to the Bank Holding Company Act, banking companies may acquire out-of-State banks only if the acquisition is explicitly authorized by the State in which the target bank is located. Every State has enacted legislation permitting some degree of interstate banking. Indeed, the number of banking companies with multistate operations increased more than tenfold between 1980 and 1992. The number of banks they operated jumped from 279 to 1,277, and the volume of banking assets in those multistate companies rose from $85 billion to over $2.2 trillion, nearly 64 percent of all U.S. commercial banking.

Nonetheless, interstate branching needs a boost, and on October 25, Secretary Bentsen announced the administration's plan, under which:

- Any bank holding company would be permitted to consolidate its existing bank subsidiaries headquartered in another State (the "host" State) into multistate branches of a single bank and to acquire a bank headquartered in the host State, unless that State opted-out of such consolidations and acquisitions.
- Once an out-of-State bank holding company had acquired a bank in a host State, it could convert the acquired bank into branches.
- After such an acquisition and consolidation, the out-of-State bank would be free to branch anywhere within the host State, limited only by any restrictions that host State law places on intrastate branching.
- States that preferred not to allow acquisitions and consolidation into branches by out-of-State banks would be free to opt-out.

This approach clearly builds on the strengths of the dual banking system and will yield a stronger banking system.

The greatest additional safety and soundness advantage afforded by interstate branching is lower costs and by achieving lower costs, banks will be able to augment capital, directly improving safety and soundness.

An important part of bank safety is, we would all agree, effective bank supervision. I believe that interstate consolidation would not present supervisory challenges that the OCC does not already face in supervising large multibank companies.

While we believe that interstate branching through consolidation of commonly owned banks is good policy, the administration is committed to ensuring that the benefits of a safe and sound banking system extend to all segments of society. Find-

ing better ways to encourage banks to invest in their local communities is a key part of that commitment, particularly with expanded interstate branching.

As banking firms consolidate their operations, the responsibilities of individual banks under the CRA will naturally multiply. I believe that the revised CRA evaluation process will provide an appropriate model for assessing the performance of banks with interstate branches.

I also believe that there is ample evidence to suggest that interstate branching will not seriously challenge other important attributes of our banking system: its competitiveness and the vital role played by community banks.

Consequently, interstate branching would be an important step toward permitting banks to better meet the convenience and needs of the banking public, while enhancing the safety and soundness of the banking system.

## Introduction

Mr. Chairman and Members of the committee, I appreciate this opportunity to testify on interstate branching. Markets for financial services have no natural geographic boundaries. Yet, banking firms are, for the most part, required to do business through separately chartered subsidiary banks in each State in which they operate. This inconveniences customers who bank in more than one State and drives up the cost of banking services.

Permitting banks to operate interstate branching networks should help improve the safety and soundness of the banking system and it should help banking companies provide more convenient and cost-effective service to their customers.

## Interstate Banking Today

The authority of banking firms to provide services across State borders is currently limited by two provisions of Federal law:

- The Douglas Amendment to the Bank Holding Company Act permits banking firms to acquire out-of-State banks only if the acquisition is explicitly authorized by the State in which the target bank is located. Every State has enacted legislation permitting some degree of interstate banking. But interstate banking under the Douglas Amendment must be conducted through separately incorporated subsidiaries of a bank holding company.
- Direct interstate branching is more severely restricted. The McFadden Act virtually prohibits interstate branching by national banks and by State banks that are members of the Federal Reserve System. Most States have enacted similar restrictions that apply to State-chartered banks that are not Federal Reserve members.

The constraints on interstate banking that these statutes provide are in many ways more nominal than real. As shown in the accompanying table, the number of banking companies with multistate operations increased more than tenfold between 1980 and 1992. The number of banks they operated jumped from 279 to 1,277, and the volume of banking assets in those multistate companies rose from $85 billion to over $2.2 trillion, nearly 64 percent of all U.S. commercial banking assets.

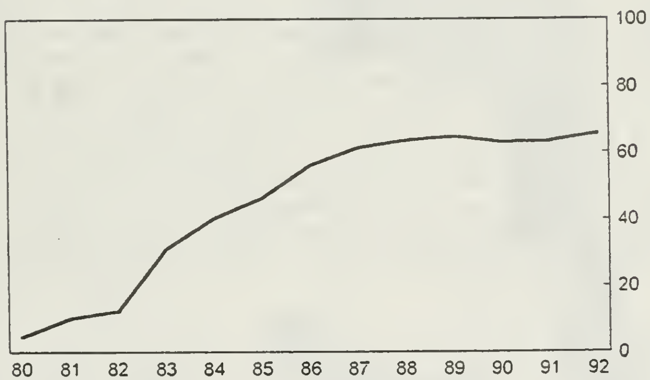
The banking map of the U.S. today, shown after the table, tells a similar story. Every State in the Nation has acted to permit entry by out-of-State banking companies, in one form or another. Although most States continue to place some restrictions on interstate banking,[1] those restrictions are not, for the most part, geographical in nature. In fact, whatever limitations they may impose, thirty-five States permit entry by banking companies from any other State either on a reciprocal or unrestricted basis. The remaining fifteen States and the District of Columbia permit entry, all but Hawaii on a reciprocal basis, by banking companies headquartered in nearby States.

[1] Restrictions include barring *de novo* entry, limiting acquisitions to failed banks, requiring that acquired banks be older than some specified number of years, and requiring that a specified percentage of the assets of the acquiring company be located in a specific region. Hawaii, for example, limits out-of-State entry to banks headquartered in selected U.S. territories and to acquisitions of failed or failing banks by banking companies located in the twelfth Federal Reserve District, but only after all Hawaii banks have turned down the opportunity to buy the failing bank.

# Multi-State Bank Holding Companies Grow in Importance*

| | # of MSBHCs | # of Banks | # of Branches | Assets MSBHCs ($B) | Total CB Assets ($B) | MSBHC Asset Share (%)** |
|---|---|---|---|---|---|---|
| 1992 | 177 | 1,277 | 27,068 | 2,205 | 3,459 | 65.65 |
| 1991 | 174 | 1,295 | 26,980 | 2,144 | 3,383 | 63.38 |
| 1990 | 171 | 1,313 | 26,581 | 2,109 | 3,341 | 63.13 |
| 1989 | 160 | 1,403 | 25,537 | 2,103 | 3,251 | 64.69 |
| 1988 | 143 | 1,403 | 24,267 | 1,960 | 3,079 | 63.66 |
| 1987 | 132 | 1,438 | 22,399 | 1,824 | 2,969 | 61.44 |
| 1986 | 100 | 1,252 | 18,690 | 1,639 | 2,919 | 56.15 |
| 1985 | 65 | 720 | 12,514 | 1,259 | 2,718 | 46.32 |
| 1984 | 53 | 465 | 9,484 | 1,010 | 2,502 | 40.37 |
| 1983 | 33 | 317 | 6,193 | 729 | 2,338 | 31.18 |
| 1982 | 21 | 284 | 2,838 | 272 | 2,188 | 12.43 |
| 1981 | 18 | 277 | 2,348 | 208 | 2,028 | 10.26 |
| 1980 | 16 | 279 | 1,823 | 85 | 1,849 | 4.60 |

MSBHCs' Share of Banking Assets Grows

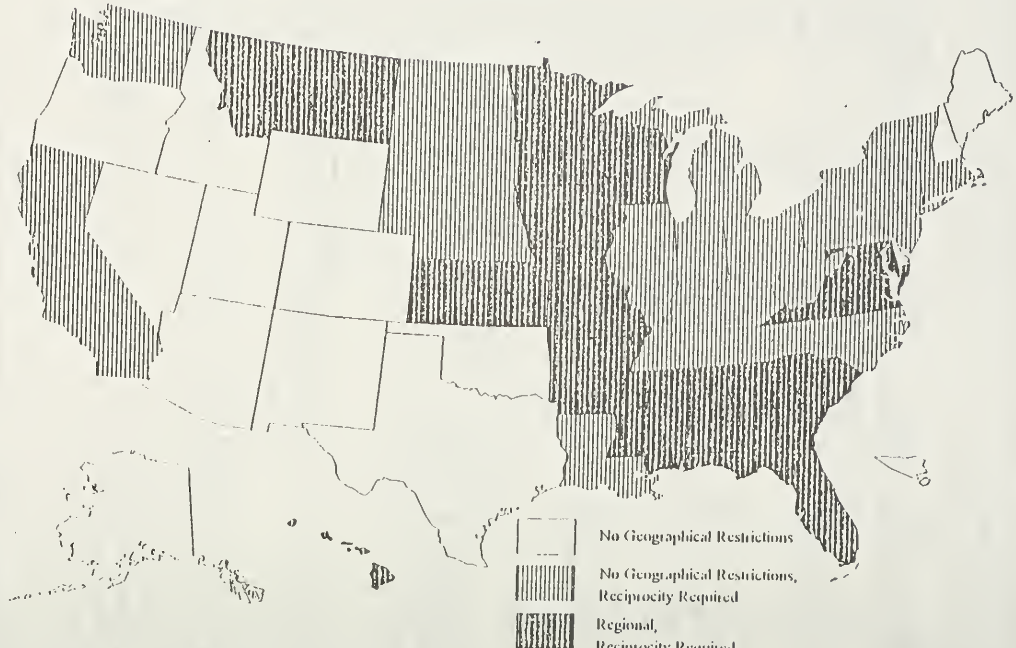



*Multi-state bank holding companies (MSBHCs) include all bank holding companies which have FDIC-insured commercial banks in at least two states. Number of branches excludes ATMs. Data are year-end.

**Share of commercial banking assets held by MSBHCs.

Source. Call Reports

## All States Permit Holding Company Entry
October 1993



The willingness of States to open their borders to out-of-State banking and the consequent growth in multistate banking companies has taken place against a background of activity at the Federal level. To facilitate the resolution of failed banks, Congress, beginning with the Garn-St. Germain Depository Institutions Act of 1982, permitted holding companies to acquire closed banks with assets in excess of $500 million on an interstate basis notwithstanding State law. Congress expanded this authority in the Competitive Equality Banking Act of 1987 to include, among other things, the emergency acquisition by out-of-State banking companies of banks that are in danger of closing and that have assets in excess of $500 million. Congress has also authorized the Resolution Trust Corporation to override State laws, including branching laws, to facilitate the acquisition of failed thrifts by banks.

In addition, Federal thrifts may engage in unrestricted interstate branching, subject to certain exceptions, in accordance with rules that the Office of Thrift Supervision issued in May of 1992.

Whatever stimulus for change Federal activity may have provided, market pressures were clearly at work. For many years, national banks have been establishing loan production offices where they could not establish branches, in order to serve customers operating in more than one State. National banks also may permit customers to have access to withdrawal services, and in some cases deposit services, without geographic limitation by joining interstate ATM networks.

More recently, various forms of home banking, electronic banking, point-of-sale terminals, banking by mail, and use of third party messenger services have also enabled banks to expand the geographic range of their services consistent with current law. Some banks are considering providing such accommodation services on an interstate basis.

This erosion of artificial barriers to interstate banking is a natural outgrowth of improvements in information technology. As bank products have become more standardized and information processing technology has become more powerful and affordable, it has become easier for banks to provide services over increasingly large geographic areas. Bank customers have also become more mobile. Rather than conducting all of their banking business at a single branch, they now demand access to banking services wherever they are, often in places other than their home State.

While interstate banking has grown steadily and broadly over the last decade, interstate branching—the opportunity to have branches, rather than subsidiary banks—in multiple States has lagged far behind. To date, only nine States permit interstate branching: Alaska, Connecticut, Massachusetts, Nevada, New York, North Carolina, Oregon, Rhode Island, and Utah. All but Utah require reciprocation by the State that headquarters the bank seeking entry. Because of the McFadden Act, only State banks that are not members of the Federal Reserve System may take advantage of those laws.

### A Prescription for Change

Giving a well-structured boost to interstate branching is not a simple task, for it requires a careful weighing of several important factors. In taking on that challenge, I apply the same two-part test that we apply to all other new banking activities. To be permissible under this test, a new activity:

- should not adversely affect safety and soundness; and
- should, on balance, benefit consumers of financial services—large and small businesses as well as individuals.

A fair application of this test clearly implies that Federal law should permit interstate branching, and we are taking steps to secure that result. On October 25, Secretary Bentsen announced the administration's support for a change in Federal law that would give interstate banking companies the opportunity to consolidate their banking subsidiaries into branching networks, with the approval of the appropriate State. We support a change under which:

- Any bank holding company would be permitted to consolidate its existing bank subsidiaries headquartered in another State (the "host" State) into multistate branches of a single bank and to acquire a bank headquartered in the host State, unless that State opted-out of such consolidations and acquisitions.
- Once an out-of-State bank holding company had acquired a bank in a host State, it could convert the acquired bank into branches.
- After such an acquisition and consolidation, the out-of-State bank would be free to branch anywhere within the host State, limited only by any restrictions that host State law places on intrastate branching.
- States that preferred not to allow acquisitions and consolidation into branches by out-of-State banks would be free to opt-out.

This approach builds on the strengths of the dual banking system. National banks and State-chartered banks that are members of the Federal Reserve System (member banks) would not be permitted by Federal law to establish *de novo* branches across State lines, although States would be free to permit entry by branching as they are today. Only the States could decide whether to opt-out, i.e., whether to prohibit out-of-State bank holding companies from consolidating their bank subsidiaries into multistate branch banks. State laws would also control the terms and conditions of additional branching within the State, as they do today. Further, States would be allowed to forbid acquisitions and consolidations by out-of-State banks and bank holding companies.

Permitting banks to build interstate branch networks will allow them to provide more convenient and cost-effective service to their customers. Within each branch system, customers would be dealing with the same bank in every State and could make withdrawals and deposits in any branch and still have all transactions recorded as part of their account at the surviving bank, wherever it might be located. The banking organization itself would be more efficient, in part because all the branches would have common policies and operating procedures.

I will now discuss why interstate branching, as we envision it, meets my two-part test.

## Bank Safety and Bank Customers

### *Bank Safety*

There are several important elements to bank safety. Interstate banking has permitted banking companies to diversify their asset portfolios and their sources of income more fully, reducing the impact of an economic shock in any particular region, and providing a greater margin of safety to the bank and its deposit insurer. Moving from interstate banking to interstate branching increases the ease of accomplishing further diversification.

However, the greatest additional safety and soundness advantage afforded by interstate branching is lower costs. By reducing operating costs, interstate branching would increase returns on equity, directly strengthening the industry's bottom line. Indeed, consolidation of multibank holding company bank subsidiaries into branches would generate cost savings in a variety of ways. It would eliminate the need for multiple charters, boards of directors, and administrative structures; facilitate the consolidation of back-office operations; and allow banks to achieve greater economies in the advertising and marketing of financial services.

Consolidation of banks into interstate branching networks would also reduce the burden of complying with Government regulation by decreasing the number of regulatory reports that the bank must file and the number of requests for information that it receives from its supervisor. For example, each quarter, every bank submits a Report of Condition and Income (Call Report). Those reports are approximately 30 pages long and include about 600 items for banks with over $100 million in assets and about 400 items for smaller banks. Thus, a multibank holding company with 10 separate affiliate banks submits 10 reports each quarter. If a multibank holding company could consolidate its banks into a single bank with branches in several States, it would have to provide only one set of information, not several sets. Savings such as these would complement current efforts by the OCC to reduce unnecessary regulations.

To the extent that banks achieve the potential cost-savings available to them, they will be that much stronger. Consolidation of operations into branches would leave the banking firm's consolidated balance sheet unchanged; it would not add in any way to the risks of banking. Instead, by reducing operating costs and increasing the convenience and value of banking services, consolidation should improve the financial condition of national banks. By realizing cost savings, banks will be able to augment capital, directly improving safety and soundness.

### *Supervising Interstate Branching Networks*

An important part of bank safety is, we would all agree, effective bank supervision. I believe that interstate consolidation would not present supervisory challenges that the OCC does not already face in supervising large multibank companies. Money-center and super-regional banking firms have complex and far-flung operations that often extend over several States and more than one OCC supervisory district. We have met the supervisory challenges posed by those banking companies. The switch from multibank holding companies to consolidated interstate banks could ultimately reduce the severity of these supervisory challenges and allow us to concentrate our resources further on reducing systemic risks to the banking industry and eliminating unfair, deceptive, and discriminatory lending practices.

Our experience in the supervision of large multibank organizations has also prepared us well for supervising consolidated interstate branch networks. Our objectives in supervising national banks involve: assessing the condition of each bank and the risks associated with its current and planned activities; determining if risk management systems exist, and if those systems are properly designed; communicating with bank management and board(s) of directors in a timely and clear fashion about our supervision, the findings of supervisory activities, and those matters that require corrective or remedial attention; causing banks to correct deficiencies in condition and/or risk management systems; and validating the correction of deficiencies. The organizational structure used by the financial institution to provide banking services, whether a multibank holding company or a consolidated interstate bank, does not alter these basic supervisory objectives.

Consolidation of interstate operations of multibank holding companies should also provide net operating efficiencies to the regulatory system as a whole. Federal law requires the OCC and the other Federal banking agencies to conduct annual examinations of each bank within its jurisdiction. The elimination of the need to maintain separate charters in each State in which financial institutions operate will likely reduce the total number of banks within any given organization and, therefore, reduce the number of separate examinations the regulatory agencies are required to conduct each year. Importantly, a potential reduction in the total number of chartered entities examined will not undermine safety and soundness. Consolidation should permit the supervisory agencies to focus more sharply on the risks to the organization as a whole, to conduct a more efficient review of overall asset quality, and to provide a truer picture of the condition of the institution.

Consolidation may also promote efficiencies in the performance of each examination. For example, the switch from a multibank holding company to a consolidated interstate bank will reduce the total number of directors, officers, and other insiders in any given financial institution and, therefore, make it easier to identify and take corrective action for violations of insider regulations. These changes can only improve bank safety and soundness.

*Consumer Benefits*

While the primary benefits of interstate banking consolidation would be in the form of lower bank costs, the potential for some important consumer benefits also exists. It appears that interstate banking has benefited consumers by increasing competition and expanding the array of financial services. Even so, there is much room for improvement. Currently, banking is not as convenient as it could be for consumers who frequently travel across State lines. For example, a customer of a bank in New Jersey located near his or her home may not be able to obtain, conveniently, banking services at an affiliated bank in New York City located near his or her place of work. Consolidation of separately chartered banks into branches under a single charter would make it much easier for customers to conduct transactions at any branch throughout the entire service area of the consolidated bank.

While we believe that interstate branching through consolidation of commonly owned banks is good policy, in part because it will benefit consumers, consumer protection must remain a high priority for bank supervisors.

CONSUMER PROTECTION

The administration is committed to ensuring that the benefits of a safe and sound banking system extend to all segments of society. Finding better ways to encourage banks to invest in their local communities is a key part of that commitment, particularly with expanded interstate branching.

CRA regulations require banks to address the credit needs of their delineated communities. As banking firms consolidate their operations, the responsibilities of individual banks under the CRA will naturally multiply, and bank supervisors will have to find ways of ensuring that banks that have branches in widely separated areas help meet the credit needs of all of the communities they serve. Interstate branching should not impair CRA performance.

This is a challenge that we can surely meet. It is the same problem that Federal banking agencies and banks already face in crafting meaningful CRA evaluations in States that permit Statewide branching. This is one of the issues that the Federal banking agencies are currently reviewing as part of the President's initiative to make fundamental changes in CRA administration. I believe that the revised CRA evaluation process will provide an appropriate model for assessing the performance of banks with interstate branches.

For all of its importance, CRA is not the only Federal protection of consumer interests. Other protections are provided by laws extending from the Equal Credit Opportunity to Fair Housing to Truth in Lending and Truth in Savings, just to name

a few. As in the case of CRA, bank supervisors have had ample experience in enforcing those laws with respect to large intrastate branching networks. We are prepared to enforce them with respect to large interstate branching networks.

Service to the community is not, of course, defined exclusively in terms of adherence to consumer protection and related laws. It is also defined in terms of the personalized service that is the hallmark of community banks. We are confident that community banks will continue as strong competitors in an era of interstate branching.

When large and community banks compete in the same geographic markets, the performance of community banks remains competitive. Pennsylvania, for example, moved from highly restrictive branching to full intrastate branching during the 1980s. Small banks continue to operate successfully there. At the end of last year, there were 281 insured banks in Pennsylvania. We divided them into four size classes—banks with assets: under $100 million; between $100 million and $1 billion; between $1 billion and $10 billion; and over $10 billion. We then computed the median return on assets (ROA) for each size class. Beginning with the smallest size class the median ROAs were: 1.01 percent, 1.13 percent, 1.15 percent, and 1.03 percent, respectively.

The performances of banks of all sizes does vary from year-to-year and from State-to-State for a host of reasons, ranging from the conditions of local and national economies to where banks are in their long-run strategic plans, to changes in management or management philosophy. However, for the reasons I have cited, we expect community banks to retain their traditional role in local credit markets, and credit-worthy local borrowers should continue to be able to obtain the financing they need. Successful banks traditionally have been those that best meet the needs of the markets they serve. Competitive forces have led many large banks to become adept at providing a high volume of services at low cost, but this advantage is generally limited to products that do not require a high degree of personal service. Many small banks, on the other hand, have excelled at providing high-quality, personalized services to their clients. This is particularly true of small business lending, which requires knowledge about small borrowers and local credit conditions that community banks are more likely to possess. Local customers who value customized service are therefore likely to continue to seek the financial services of smaller banks, whether or not a branch of a large bank is located across the street.

Finally, we must continue to ensure the proper application of the antitrust statutes to banking; those laws provide important protections against undue concentrations of economic power. Earlier this year, Mr. Chairman, you requested that the OCC assess the effects of the consolidation that has occurred to date in the banking industry. I would like to summarize our detailed responses, which we have provided to you in a separate letter.

First, we must exercise great care in measuring concentration. Researchers often encounter severe difficulty in accurately identifying all relevant competitors and measuring their share of the relevant market. Competitor identification is especially important, since the inclusion or exclusion of different types of financial services firms affect the size of concentration ratios.

We must also be careful in interpreting the economic significance of concentration ratios. For example, in assessing the possible implications of particular concentration ratios on competition in a market, analysts need to take into account the ease with which competitors may enter that market. The greater the ease of entry, the less is the significance of a particular concentration ratio.

We also need to be concerned about how we identify the markets that should warrant our vigilance. Banks are multiproduct firms and most experts seem to agree that in banking the size of the appropriate geographic market depends significantly upon the types of products and services banks sell. Some services, such as lending to small businesses may be offered in small, local markets, while other services, such as lending to regional and national firms, would cover much larger areas.

In the light of those considerations, we are skeptical about the competitive implications of Statewide ratios that measure the concentration of banking assets or other indicators of bank products. Nonetheless, OCC staff computed the Herfindahl-Hirschmann concentration index (HHI), a measure of concentration preferred by many researchers,[2] for banking assets, State by State, for 1986 and 1992. The median index dropped by one point over that period, from 948 to 947. The median

[2] In contrast to typical concentration ratios, HHIs take into account the market share of all institutions the researcher is studying, not just the largest ones. Lower HHIs mean less concentration.

value of the corresponding index for net loans fell nine points from 1,000 to 991. Those results indicate a reduction in concentration.

We were also particularly interested in concentration trends in local markets in Indiana, Oregon, South Carolina, and Washington, States that witnessed significant entry by out-of-State banking companies in recent years. For those States, the staff calculated deposit-based HHIs for banks and thrifts in 29 urban markets for the years 1988 through 1992. Over the four-year period, HHIs declined in 14 of the 29 markets, meaning that concentration had declined in those markets; for the remaining 15, the median increase was under eight percent. For us, those results were not especially surprising. A recent Federal Reserve study found that between the mid 1970's and 1990, the percentage of deposits in urban and rural markets nationwide that were held by the three largest banks in those markets dropped slightly, on average.[3]

### Conclusion

For many years, observers both inside and outside Government have pointed out the need to remove the archaic restrictions placed on the U.S. banking system. Our banking system would function more efficiently without them and would be better positioned to meet the convenience and needs of the banking public. Interstate branching would be an important step in that direction, permitting banks to serve their customers better and at lower cost, while enhancing the safety and soundness of the banking system.

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## PREPARED TESTIMONY OF BARBARA WALKER

State Banking Commissioner for the State of Colorado

on behalf of the

Conference of State Bank Supervisors

November 2, 1993

Thank you, Mr. Chairman. My name is Barbara Walker and I am the State Bank Commissioner for the State of Colorado. I am testifying today on behalf of the Conference of State Bank Supervisors where I serve on the Board of Directors and as Chair of the Legislative Services Council. I appreciate the opportunity to share with your committee the views of CSBS on the important issues involved with interstate banking and branching.

As you know from earlier witnesses, all States except Hawaii have enacted some form of interstate banking. The majority of States, 35, allow bank holding companies from any other State to acquire banks in their State. Regional interstate banking is the rule in 14 States and the District of Columbia, primarily in the southeast and midwest. A few States allow interstate branching for their State chartered banks. Significantly, four States passed comprehensive interstate branching legislation recently. These States are New York, North Carolina, Oregon, and Alaska.

### Current Legal Framework

Prior to discussing the State view of interstate banking and branching, I wish to review the current framework that regulates bank geographic location. States play the lead role in determining the location of banks within their borders. It is important to keep in mind our current structure to understand the State concerns raised by interstate branching.

Interstate banking is the acquisition of banks by a bank holding company with its principal location in another State. Interstate banking is controlled by section 3(d) of the Bank Holding Company Act, generally referred to as the Douglas Amendment. The Douglas Amendment places with the State the decision whether to permit out-of-State bank holding companies to acquire local banks. The Supreme Court interpreted the Douglas Amendment to allow States not only to permit or deny interstate banking, but also to place conditions, restrictions, and limitations on the acquisition of local banks. In addition to regional requirements, States have enacted a number of supervisory conditions on out-of-State bank holding company acquisition of local banks.

Section 7 of the Bank Holding Company Act reserves to the States broad regulatory authority over bank holding companies. Unlike the Douglas Amendment, sec-

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[3] Statement by John P. LaWare before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, October 5, 1993, Table A–6.

tion 7 does not permit States to treat out-of-State bank holding companies differently from in-State institutions. States use the authority under section 7 to apply consumer protection and community reinvestment requirements to bank holding companies.

Interstate branching by national banks and State banks that are members of the Federal Reserve System is controlled by the McFadden Act. This provision generally prohibits national banks and State member banks from branching beyond the borders of their home State. The McFadden Act also permits national banks to branch within their home State to the extent permitted for State banks. Most States now permit Statewide intrastate branching.

There are no Federal prohibitions on interstate branching by State nonmember banks. The State nonmember banks may branch interstate if the law of the chartering State permits. There is some question whether a State can prohibit the establishment or restrict the operations of branches of an out-of-State State nonmember bank consistent with the Commerce Clause of the U.S. Constitution. While some restrictions are certainly permitted, the extent of limitations is a matter of debate.

### State Principles for Interstate Banking and Branching

CSBS hopes to be both active and constructive in the debate on interstate branching. In 1990, we began a review of interstate banking and branching. As a result of that review, we recommended that Congress amend the McFadden Act to allow national banks to branch interstate to the same extent and under the same limitations and restrictions as State banks. This approach built on the successful transition to interstate banking during the 1980's under the Douglas Amendment. This proposal became known generally as "opt-in" because it required positive action by each State to permit interstate branching. As with the Douglas Amendment, States could set terms and conditions for the entry and operation of interstate branches.

Our goal is to produce interstate branching legislation that sets into place a framework for a rational progression to nationwide interstate branching. We developed six principles to apply in judging interstate branching proposals. I would like to share these with you so you can understand our position on various provisions. Also, I hope these principles will be helpful to you in assessing the bills before you. Any interstate branching proposal should:

1. maintain full application of State and Federal consumer protection.
2. not reduce economic growth and development opportunities in all communities.
3. maintain the safety and soundness of all banks.
4. not result in revenue losses to the States.
5. not reduce State supervision of banking activities within its borders.
6. not prefer an operating structure or a type of institution.

### State Concerns with Opt-Out

This committee produced interstate branching legislation in 1991 that appeared in S.543 as Title III. This provision was substantially altered on the floor of the Senate by an amendment sponsored by Senator Ford. Unfortunately, many of the provisions that are critical to the States were deleted or subverted. We have focused our analysis on both Title III as reported by this committee and as amended on the Senate floor. We have identified five areas of critical concern to the States.

#### *Effective Dates*

The framework adopted by this committee in 1991 is generally referred to as "opt-out." Under this approach, States are given a set amount of time to decide if they do not want interstate branching. If the State legislature takes no action within the stated time, interstate branching will occur. The critical question is how long to give the States to act.

Two factors need to be considered in deciding the length of the opt-out period. First is the schedule of the various legislatures. Second is the complexity of the issue being considered. These two questions are interrelated. Studying complex issues requires more time in those States where the legislatures meet for a limited time or less frequently.

A number of State legislatures, primarily in the west, meet in regular session only once every two years. The largest State where the legislature only meets every two years is Texas. In addition, many States legislatures only meet for relatively short regular sessions. For example, the Florida legislature meets for 60 days in the spring of each year. Generally, complex measures must be sent to a study committee the prior year to be considered in the current legislative session. Special sessions are common in many States; however, most States severely limit the time and the subjects addressed in special session.

In considering interstate branching under the opt-out framework, a State legislature will face a number of complex and decisive issues. First is whether to allow

interstate branching. The current debate in Congress shows that this is a decision with intense political interest. In addition, if a State decides not to opt-out, several other complicated issues arise. These include the structure of interstate branching for State chartered banks, changes to the State supervisory structure to address interstate branching, and amendments to the State tax code to tax these new entities. CSBS is currently preparing guidelines for the States in amending their banking statutes to accommodate interstate branching. Our State tax counterparts are working to prepare a State tax system for interstate branching. However, each State's law in both areas is unique and any model must be adapted to conform to local law.

CSBS strongly believes that States should be granted a full three years from the enactment of any opt-out proposal to consider interstate branching. Three years would allow those legislatures that meet less frequently to fully address the issue and allow sufficient time to address State law changes that will be required. The full opt-out period should apply to both consolidation of existing multistate institutions as well as future interstate branching. Consolidation raises the same State tax and supervisory issues. As I will discuss later, consolidation creates additional supervisory concerns in a number of States.

*Applicable Law*

How an interstate branch will operate within a State is governed by the applicable law provisions. These sections dictate what protection will be provided to consumers and communities in the interstate branching environment. These provisions are some of the most controversial in the legislation.

In order to understand the purpose of the applicable law sections, it is important to understand the interaction between State and Federal law as it applies to national banks and bank holding companies. National banks are generally subject to State laws provided the State law in question does not directly conflict with a Federal law, does not discriminate against national banks, or does not place an undue burden on the operation of the national bank. The OCC, as the supervisor of national banks, is charged with enforcing all laws applicable to a national bank, both State and Federal. State authorities are prohibited from examining national banks or taking administrative enforcement actions against national banks. States can, however, go to court to prevent violations of State law by national banks. The most important concept is that the OCC determines which State laws apply and which are preempted. There is no practical limit on the OCC's ability to preempt State law.

The States have a great deal of regulatory authority over bank holding companies. As we discussed before, section 7 and the Douglas Amendment of the Bank Holding Company Act preserves rather than preempts State law as it applies to bank holding companies. In addition, States examine bank holding companies and may use administrative enforcement powers to prevent violations of State law by bank holding companies. The States have applied various consumer protection laws and community reinvestment requirements to bank holding companies. These laws may have been preempted by the OCC if directly applied to national banks.

Interstate branching creates a problem for State regulation of bank holding companies; namely, there is no holding company to regulate. The point of interstate branching is the elimination of separate subsidiaries in every State. Instead, the principal bank will operate branches in each State. There will no longer be any regulatory nexus between the host State and the parent bank holding company. Two results are possible. Either the laws will no longer apply to that institution or they will be subject to preemption by the OCC.

In recognition of this result, this committee crafted a compromise in 1991. It identified four areas where State law would apply to the branches of an out-of-State national bank as if it were a bank chartered by that State. These areas were intrastate branching, consumer protection, fair lending, and community reinvestment. These laws could only be preempted by another Federal law on the same subject or if they discriminated against the out-of-State bank. This preserved the treatment of these laws under section 7 of the Bank Holding Company Act. Enforcement was left to the OCC, although the State could still seek judicial intervention to prevent violations. Laws of the host State that do not fall into one of the four categories would apply as if the branch were a national bank in that State and be subject to preemption by the OCC.

Unfortunately, the Ford Amendment stripped away most of the language and reversed the impact of the provision. Under the Ford Amendment, host State law would only apply in the four areas and these laws are subject to preemption. Apparently all other law would be imported from the home State. We have raised our concerns with Senator Ford and are working with him on these provisions.

The Clinton administration recognized the importance of this section and the application of these laws last week. In his statement before the House Subcommittee on Financial Institutions, Under Secretary Newman pointed to the section of the Vento bill that was modeled on the Senate Banking Committee version of applicable law. He stated that the applicable law section is important to "preserve State's authority to determine banking structure and otherwise regulate financial institutions within their borders."

There is a recent example of preemption of State consumer laws by the OCC that illustrates the problem we are discussing. Earlier this year the OCC issued Interpretive Letter No. 614 that swept away important State consumer protection laws. Laws in the States of Idaho, Wyoming, and Wisconsin that provide important protection for consumers who obtain credit from banks and other lenders were preempted by the OCC. The basis for preemption was not a direct conflict with the National Banking Act or any discriminatory impact on national banks. The OCC instead claimed through a contorted reading that State required reports are "visitations" prohibited by section 484 of the National Bank Act. Besides being in clear conflict with U.S. Supreme Court holdings allowing States to require reports from national banks to assure compliance with valid State law, the ruling has brought into question the application of the Uniformed Consumer Credit Code to national banks.

We urge you to adopt the applicable law section of S. 543 as approved by you in 1991. While this is a complicated and controversial area, it is critical to assuring that consumers and communities are treated fairly.

*State Conditions*

Similar to the applicable law provisions, this committee included a section in its version of S. 543 that permitted States to set certain conditions on the entry and operation of interstate branches. These conditions were restricted to only those that were nondiscriminatory in application and effect. Also, the enforcement of the conditions was left to the OCC.

The impact of this section is to allow States to treat all institutions equally. Unlike State action under the Douglas Amendment for interstate banking, no regional restrictions or conditions that apply solely because an institution is operating across State lines are permitted. However, State conditions authorized under section 7 of the Bank Holding Company Act would be preserved. These requirements have generally focused primarily on reporting to allow States to assess the banking services offered. This allows States to assure that all consumers and communities in the State are being served.

The Ford Amendment eliminated this provision from S. 543. By not permitting State conditions, interstate branches will have a competitive advantage over in-State banks and over those institutions that choose to retain separate subsidiaries. In addition, nondiscriminatory conditions that currently apply will be lost; significantly reducing State oversight of the institutions that offer financial services in the State. We ask that this provision be restored.

*Parity for State Banks*

Under all interstate branching proposals in Congress, additional State action is required to allow State banks to branch interstate. Four States have recently enacted interstate branching for State banks. The remaining States must act to allow State banks to branch beyond the State's borders. While this power should remain with the States, there must be sufficient time for the States to act on interstate branching.

The concern for State bank parity raises two other concerns. First, it is important that the Federal legislation not include additional requirements on State bank interstate branching beyond that imposed for national bank interstate branching. Also, because of the preemptive nature of the National Bank Act, an applicable law section that insures that all out-of-State banks will be subject to the same host State law is critical to assure parity between State and national banks. Otherwise, branches of a State bank will be subject to requirements of the host State that may not apply to interstate branches of a national bank.

The final parity concern arises from the proposal to enact an earlier effective date for consolidation of existing interstate bank networks. Besides being blatantly unfair, this would encourage using national banks as the surviving institution following consolidation. There should be no preference or advantage granted either the State or national charter in Federal interstate branching legislation.

*State Taxation*

CSBS appreciates the willingness of this committee to address the concerns with the impact of interstate branching on State revenues. There are several provisions

in the legislation from 1991 that directly address the State tax questions. Also, the Multistate Tax Commission has developed additional language to assure that any interstate branching legislation is neutral regarding State tax policy. We will continue to work with our counterparts at the Multistate Tax Commission and at the Federation of Tax Administrators to provide assistance to you in this complicated area.

It is important to note that no further Federal "fix" is needed regarding State taxes in this legislation. The States have the authority and the tools necessary to devise a taxing method that fairly apportions tax revenues among the States where a multistate branch bank operates. This already is a matter of a great deal of discussion and work among the States. However, more time is required.

Banking is still a local activity in the sense that there must be a separate subsidiary in every State. Most States continue to use a method of taxing banks that reflects this reality. These tax methods work well today but are inadequate to tax a multistate branch bank. States are familiar in dealing with multistate operations in the general corporate setting. However, banking raises a number of questions that are not present in taxing retailers or manufacturers. The Multistate Tax Commission is currently working on a draft proposal to tax multistate banking operations. The draft is due to be presented in mid-1994. After that, individual States must study the proposal and adapt it to their individual tax systems.

### Consolidation Proposals

One question being debated is whether to produce a comprehensive framework for interstate branching or simply allow those multistate bank holding companies to consolidate already existing operations. From the State perspective, consolidation creates the same problems as any other interstate branching method and raises several new concerns. First, it is extremely unfair to smaller institutions. While it may be feasible for a small institution to establish or buy a branch across a nearby State border, it may not be feasible to acquire an existing bank in that State. In addition, to the extent that there are any consumer benefits of interstate branching, very few new consumer benefits arise from consolidating existing banks. Consolidation raises all of the State concerns with applicable law, parity, and taxation discussed above. Consolidation creates a concern about the ability of States to enforce agreements entered into with out-of-State banks under the Douglas Amendment.

Any consolidation proposal adopted must contain an opt-out and should have a minimum of three years prior to becoming effective. It is argued that since a State legislature ten or twelve years ago permitted interstate banking the State either will not care or has somehow forfeited its interest in interstate branching. This is simply incredible. Given the immediate impact of consolidation on State taxation and supervision, we are, and we believe the State legislatures will be, more concerned about consolidation of existing institutions than new interstate entrants.

### Conclusion

I have purposefully not discussed the arguments for and against interstate branching. You have had a number of witnesses concentrate on that debate and our views were presented to this committee in the last Congress. Our conclusion then and now is that some consumers and communities, as well as certain institutions, will benefit from interstate branching. The benefits will be localized and not greatly significant. In addition, the proponents of interstate branching tend to overstate the benefits.

One area where this overstatement is particularly evident is the projected cost savings to the industry from consolidation. If every multistate bank holding company fully consolidated to interstate branches, there will undoubtedly be some efficiencies and cost savings. Using the most generous projected cost savings, our analysis shows a total savings of approximately $750 million per year industry-wide. This number is overstated as well. Many of these institutions have already captured many of the savings by enhancing technology and consolidating back room operations.

CSBS prefers the opt-in approach to interstate branching. It allows States to adapt interstate branching to local needs in the same way that interstate banking evolved under the Douglas Amendment. We appreciate the statements of the Clinton administration on the issue of interstate branching. They indicate an understanding of and a sensitivity to the concerns of the States. We look forward to working with the administration in addressing our common concerns and goals. If the committee decides to go forward with an opt-out proposal, we urge you to allow a full three years for State action. We also strongly urge you to address the concerns I discussed earlier. We stand ready to assist this committee in any way to produce a workable interstate branching framework.

Thank you for the opportunity to share our views with you. I will answer any questions you have at the appropriate time.

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## PREPARED TESTIMONY OF GERALD M. NOONAN

### President and CEO of the Connecticut Bankers Association

The Connecticut Bankers Association represents 85 percent of the banks and thrifts in the State of Connecticut with over $63 billion in assets. Members are both large and small, Bif and Saif insured, and operate under various forms of charter and of course a host of State and Federal regulators. Since we in Connecticut have had powers parity among all financial institutions for almost a decade, I will refer to all institutions herein as banks.

I have been asked to testify as to the desirability of the adoption of a Federal interstate bank branching statute along the lines of the language of former Senate Bill 543 (passed by the Senate on November 21, 1991).

The answer is a simple yes. We in Connecticut find it to be a basically desirable concept. I will make only the following brief observations.

No matter what Congress does, the banking industry will continue to consolidate. Advances in communications are driving change in financial services, as well as other industries at an almost dizzying speed.

Interstate branching is but one of the issues we must face. As with many problems it has its own peculiarities and consequently I think it is *imperative* that any legislation dealing with it must do so on a stand alone basis. While it is convenient and occasionally desirable to link conceptually different issues I feel strongly that this is not such a time. If branching becomes tied to other issues or concepts the dissident voices in the industry who are willing to support what must eventually happen, will splinter and delay an advancement which really should be put in place now.

Another essential, covered in the bill, is the concept of allowing for State flexibility when dealing with "de novo" branching, small banks options, and other intrastate issues. This highly desirable aspect allows all States to begin to match their intrastate differences with a broader interstate approach, and hence gradually move the industry in the desired direction.

In conclusion I would say that while this issue is not something that Connecticut banks need to have resolved right this second, it is nevertheless a logical preparatory move toward the rapidly changing financial landscape that awaits us. We in Connecticut support the legislation.

Thank you for your consideration and courtesy.

The National Community Reinvestment Network



# ANY EXPANSION OF BANK POWERS SHOULD DEPEND UPON STRONG CRA REFORM AND OUTSTANDING BANK PERFORMANCE

BEFORE
THE SENATE BANKING HOUSING & URBAN AFFAIRS COMMITTEE

November 2, 1993

*Presented By*
*The Organization for a New Equality*
*The National Community Reinvestment Network &*
*The Greenlining Coalition*


485 Columbus Avenue, Boston, MA 02118 (617) 424-ONE-1
A project of the Organization for a New Equality

# ANY EXPANSION OF BANK POWERS SHOULD DEPEND UPON STRONG CRA REFORM AND OUTSTANDING BANK PERFORMANCE[1]

Chairman Riegle and distinguished members of the Senate Banking Committee I appreciate that you have convened this hearing to examine the issue of nationwide banking and branching and the insurance activities of national banks. I appreciate that you have invited me to testify on behalf of the constituency I represent regarding our concerns about this matter.

My name is Charles Stith and I am head of the Organization for a New Equality and the National Community Reinvestment Network. The National Community Reinvestment Network is comprised of affiliate organizations in over 70 cities. It includes organizations like the Greenlining Coalition[2], based in California, that has secured $19 billion in CRA agreements, to the Dalton Reinvestment Group in Dalton, GA struggling at a small grassroots level. NCRN's primary focus is to insure that the Community Reinvestment Act work in a way that results in a more just and equitable relationship between the lending community and our communities which are low and moderate income communities, particularly communities of color.

## Helping Greenlining Banks End Insurance Redlining

Today, we would like to focus on one possible area of expansion of bank powers that could be of mutual benefit to both banks and the inner cities. Specifically, we would favor carefully and narrowly crafted legislation permitting banks that are outstanding in serving the inner city to sell insurance in the inner city. Our proposal would be conditioned upon:

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[1]Presented by Reverend Charles Stith, President of the Organization for a New Equality and Chairman of ONE's CRA project, the National Community Reinvestment Network. The address for ONE is 485 Columbus Avenue, Boston, MA 02118. The telephone number is (617) 424-6631.

[2]Members of the Greenlining Coalition include the Black and Hispanic Chambers of Commerce, Urban Leagues and community groups such as Latino Issues Forum, Chinese for Affirmative Action and California Rural Legal Assistance.

1. Substantial reforms in CRA so that CRA ratings are based on performance and full disclosure, by race, ethnic background and gender, of business and consumer loans, as well as home loans.
2. Eligibility limited to banks that receive an "outstanding" or "high satisfactory" CRA rating, based upon performance-based CRA ratings; and
3. Limiting the sale of insurance to inner cities and other areas where there is limited competition or redlining by insurance companies.

Should this legislation be enacted, we would urge a full review in two years to discuss possible further expansions of bank powers in this area.

Our reasons for supporting this modest expansion are as follows:

1. Insurance companies redline. Substantial data on this has been provided to Congressman Kennedy's banking subcommittee on this subject. In the City of Los Angeles, for example, California's second largest property and casualty insurance company, Farmers Insurance, has fewer agents than in the City of Fresno[3], a city less than one-tenth the size of Los Angeles. California Insurance Commissioner John Garamendi has testified before Congressional committees on a number of occasions to the same effect -- insurance companies redline.
2. Because insurance companies redline, the insurance which residents of minority communities have access to through FAIR plans, for example, is more expensive and limited than coverage through conventional insurers. An Aetna study in NY found these plans 300% more expensive and such plans are generally limited to fire and extended coverage, which does not recover replacement costs. The net effect is that urban consumers are paying more money for less coverage.

   It is also worth noting, that as Professor Gregory D. Squires of the University of Wisconsin, Milwaukee testified before the House Subcommittee of Consumer Credit and Insurance, that FAIR plans are one of the chief tactics used by insurers to fend off inquiries from residents of minority neighborhoods.

3. Because insurance companies redline, if there are "outstanding" banks (based on strong revised CRA ratings), it is our contention that by permitting banks to sell insurance in inner cities, there is greater pressure brought to bear on insurance companies to reform underwriting criteria which will enable banks to service inner city communities in which conventional insurers don't have a presence.

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[3] Los Angeles has 3.6 million residents. Fresno has only 350,000. Farmers, although headquartered in Los Angeles, has 75 agents in Los Angeles and 114 in Fresno. State Farm, the nation and California's largest property and casualty company has 43 agents in Los Angeles and almost as many in Fresno (34). All data is from the California Insurance Commissioner.

4. Insurance companies are subject to no CRA or equivalent standards and strongly oppose even the "HMDA-like" CRA requirements proposed in the Kennedy legislation. (H.R. 1257)

5. Our proposal is narrow, serves a specific unmet need, rewards those who serve "the entire community" and is consistent with safety and soundness requirements. That is, home and business loans in the inner city require the availability of property and casualty insurance. The absence of such insurance adversely affects the ability of bankers to make sound and safe inner city loans.

Greenlining Banks vs. Redlining Insurance Companies

If the insurance industry objects to allowing "greenlining" banks to compete against "redlining" insurance companies, their best defense is to support the terms of the pending Kennedy legislation (H.R. 1257), including disclosure of insurance by race, ethnic background, gender and census tract.

In conclusion, we urge caution in expansion of banking powers, except as we have delineated, until CRA disclosure covers all types of loans, including business and consumer loans, and CRA is performance-based, rather than based on the size of the bank's multicolored CRA brochure.

# PREPARED TESTIMONY OF SUSANNAH B. GOODMAN

## Legislative Advocate for Banking

on behalf of

Public Citizen's Congress Watch
Consumers' Union
National League of Cities
U.S. Conference of Mayors
ACORN

### Introduction

I am Susannah Goodman, a legislative advocate with Public Citizen's Congress Watch. Public Citizen is a national consumer organization founded by Ralph Nader in 1971 with over 140,000 members nationwide. Congress Watch is the lobbying arm of Public Citizen. I am testifying today on behalf of Public Citizen, Consumers Union, National League of Cities, the U.S. Conference of Mayors, and ACORN. Collectively, we represent the interests of consumers, taxpayers, local communities, and especially low and moderate income communities.

We have very serious concerns and reservations about the impact of geographic deregulation as a public policy. Past consolidation in the banking industry has increased concentration levels, reduced service for low income areas, and increased prices for consumers and borrowers.

Research, conducted independent of the influence of the banking industry, has shown that interstate banking will achieve the desired economies and efficiencies its promoters promise. To the contrary, there is an array of evidence which indicates that large interstate banks will be less efficient, less well-managed, less able to meet the credit of local communities, harder to regulate, and less safe and sound.

Moreover, there is strong evidence which indicates that interstate branching will likely lead to capital draining in some sectors of the economy at the expense of others and to a worsening of conditions for underserved areas and sectors of the economy. These are consequences that this country can not afford. When banks do not meet the credit needs of low income and minority neighborhoods, the residents are driven to usurious means of obtaining credit—and this is quite common. The proliferation of check cashing stores, pawn shops, and loan-shark operations in low income areas are evidence of this problem. Study after study reviewing the data from the Home Mortgage Disclosure Act reveals that minorities are routinely discriminated against in violation of the fair lending laws and civil rights laws.

Banks are not doing their job. Regulators and agencies are not enforcing the law. Can we truly risk *worsening conditions* for consistently underserved sectors of the economy in exchange for industry-founded promises of prosperity?

Before any legislative proposals for interstate branching are seriously considered by this committee, we urge the committee to address our concerns about interstate branching. Further research, which adequately assesses the full impact of geographic deregulation on consumers and communities, and is conducted by organizations free of the banking industry's influence, must be completed before any action is taken.

We understand that Title III of S. 543 was passed by the Senate in 1991 as part of a much larger bill designed to give banks expanded powers and to recapitalize the insolvent Bank Insurance Fund. However, this legislation was fundamentally flawed then, and it is fundamentally flawed now. The provisions in the legislation designed to safeguard *against* the harms of interstate branching are not adequate. Also, tools regulators currently have to guard against some of the ill-effects of interstate branching are not currently adequate. Any interstate branching bill should strengthen the regulators' ability to safeguard against the harmful effects of interstate branching.

### I. Disinvestment Concerns

We have grave concerns that interstate branching will lead to greater disinvestment from local communities. Disinvestment or draining occurs when banks can vacuum up deposits in one area and invest those funds elsewhere leaving the local community without credit. Disinvestment can trigger, accelerate or prolong an area's economic downturn. Interstate branching which leads to industry consolidation could severely aggravate problems of disinvestment.

In the past ten years, there has already been a great deal of consolidation in the industry. As the number of banking organizations has declined, the number of large institutions has increased.

The number of banks with assets over $10 billion in assets has increased from 27 in 1980 to 61 in 1989, an increase of 126 percent. This increase occurred while the number of banks with assets of less than $100 million decreased from 10,407 in 1980 to 7,623 in 1989. This consolidation has limited the supply of credit to local communities.

As banks have failed, merged, and been taken over, borrowers have lost their hometown creditors. These borrowers have been subject to the processes of out of State banks or money center banks who don't know them and don't understand the nature of their credit needs. Often their lines of credit have simply been called or not renewed.

I would refer the committee to an article that appeared in the Wall Street Journal from as far back as 1988 entitled *Branch Bullying: Small Texas Towns are the Latest Victims of Big Banks' Crisis*. The subtitle reads *Locals' Credit Gets Cut Off as Dallas and Houston Drain Away Deposits: No Money for Chicken Feed*. I have attached this article as an appendix to my testimony. This article shows the way that small businesses become the victims of big bank policies made far from the local community.

The 1992 Staff Report by the House Banking Committee on Banking, Finance, and Urban Affairs also examined this issue of consolidation and capital draining. According to the study, 15 holding companies with substantial interstate operations exhibited a substantial lack of commitment to a portion of the communities they served. Norwest drained funds in eight of the ten States in which it operated. BankAmerica drained funds in three of the six in which it operated and Bank of Boston drained funds in four of the four States in which it operates.[1]

According to the study, the consequences of disinvestment through satellite organizations included "triggering, accelerating, or prolonging a local or regional economic decline resulting from an institution calling loans to existing businesses, not lending to prospective local businesses, or otherwise limiting funds available to local businesses and individuals."[2]

As interstate branching will result in increased consolidation, it will aggravate these problems of credit availability. As large banks seek to expand they will likely target small banks for acquisition, rather than opening new branches. Small businesses will suffer because lending officers will be from out of town and final lending decisions will be made at far off offices insensitive to the credit needs and economic cycles of local communities and businesses.

*There is nothing in Title III of S. 543 which adequately addresses this problem of draining.* And currently, there is no simple way regulators or citizen groups can document this problem, to the extent that it already exists with large national banks and holding companies.

Consequently, we urge the committee to address this problem. In doing so, we further urge the committee to pass legislation requiring disclosure of data on commercial and industrial loans along the lines of the data disclosure requirements in the Home Mortgage Disclosure Act. Such legislation would allow for geo-coding of commercial and industrial loans along the lines of race, ethnic background, and gender. This data would be extremely useful to regulators and citizen groups who could then begin to track disinvestment accurately.

The HMDA data has been exceedingly useful for regulators and citizen groups to identify patterns of discrimination and redlining in the mortgage lending industry and to alert enforcement bodies of these problems. Commercial lending data disclosed along similar lines will allow, at least, for charting and physical proof of disinvestment patterns.

## II. Community Reinvestment Concerns

Problems of credit availability in low and moderate income areas are currently severe; interstate branching threatens to make those problems worse because enforcement of the Community Reinvestment Act will undoubtedly become more difficult. The Community Reinvestment Act currently applies to banks, not to bank branches. The bank-wide, rather than branch-by-branch, application of CRA is a fundamental flaw that already threatens communities in States where banks have extensive branch networks.

Moreover, to date the Community Reinvestment Act has not lived up to its potential in preventing redlining or lending discrimination to low and moderate income and minority communities because enforcement has been uneven at best. The Sen-

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[1] Staff Report to Committee on Banking, Finance, and Urban Affairs, House of Representatives. "Analysis of Banking Consolidation Issues," p. 1 One Hundred Second Congress. March 2, 1992.

[2] Id, at 1.

ate Subcommittee on Housing and Urban Affairs in their *Report on the Status of the Community Reinvestment Act* found that "the supervisory agencies' record of inconsistent and lax enforcement has encouraged indifference and disinterest by the financial institutions."

Indeed, collectively the agencies have given nearly 90 percent of all banks and thrifts "satisfactory" or better CRA ratings—and less than 1 percent have received the lowest rating of "substantial non-compliance"—despite evidence that neighborhood redlining remains a pervasive problem. Less than a half dozen of the thousands of merger applications that have come before the agencies since 1977 have been denied on grounds of poor community reinvestment performance by applicant banks.

The new administration, to its credit, has recognized that there is a great need to reform the regulators' approach to enforcing the Community Reinvestment Act. We look forward with great anticipation to these reforms. Because interstate branching will likely have the most devastating impact on low and moderate income communities, which are continually struggling to get credit, the promise of the Community Reinvestment Act will be that much harder to achieve. *We urge the committee to wait until we have stronger better community reinvestment enforcement tools in place before further geographic deregulation is considered.* New Federal banking regulations should be implemented within a year.

Furthermore, any interstate branching proposal should require CRA examinations *and* ratings that include branches and subsidiaries within local areas. Title III of S. 543 does not do this.

## III. Concerns About Patterns of Exclusion With Branch Closures

In recent years, large banking organizations have generally expanded on an interstate basis by acquiring other large banks or thrifts. Expansionist organizations have tended to absorb the existing branch networks of acquired banks, including branches in low and moderate income communities and minority neighborhoods.

When banks consolidate, more often than not, branches are closed in lower income, urban neighborhoods. These neighborhoods already have fewer banks; between 1980 and 1989, seventy-one percent of the branches Security Pacific closed in Los Angeles were in communities with household incomes under $35,000.[3] Although the Bronx population has remained about the same, one-fifth of the bank branches have closed since 1978.[4] Branch closings effectively reduce any access residents have to bank services and credit.

*S. 543 does not include a safeguard that will prevent or minimize the extent to which restructuring of the banking industry will lead to a major reduction in the number of banking services in low and moderate income areas.* That is, S. 543 does not safeguard against redlining by mode of branch openings and closures.

Furthermore, S. 543 does not bar further expansion by banking organizations that have exhibited expansion patterns that exclude branches in low and moderate income areas and minority communities, either through acquisition, *de novo* expansion, or through branch closings. Such a provision barring banks with patterns of exclusion is a fundamental safeguard of the evolution of the banking structure and a vitally needed compliment of basic safeguards.

Again, before an interstate branching proposal is enacted, it is imperative that regulators implement a policy of charting patterns of exclusion through branch closures. Such a proposal would not be difficult to implement and the geographic pattern for an expanding interstate banking organization would emerge slowly over time.

## IV. Concerns About Forward Commitments

Banks involved in expansion should provide, at a minimum, bank services in underserved areas and should meet with local communities to assess local needs before entering into new geographic areas.

S. 543 does not include a provision requiring banking organizations seeking interstate acquisitions to make commitments to significantly improve the basic credit and deposit services offered by the banks or branches to be acquired.

## V. Concerns About Concentration Limits and Anti-Competitive Factors

As discussed above, the trend in the banking industry over the past decade has been consolidation and concentration. As large banks control more of the assets and the number of competitors decrease, concentration levels increase. As concentration

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[3] "They Will Gladly Take a Check," *New York Times*, D1, 1992.

[4] Mark Green and Gleen von Nostitiz. "Bank Mergers are Taxing Consumers," *The Nation*, p. 81. January 27, 1991.

levels increase, borrowing becomes more expensive and at times unaffordable for low and moderate income communities.

For example, Federal Reserve economist Rhoades found higher mortgage rates in cities with high levels of concentration.[5] Federal Reserve economist Hannan has found that the structure of the local market has a substantial effect on loan rates—this was especially true for loans less than $100,000.[6]

While increasing the cost of borrowing, banks in concentrated markets pay consumers less for deposits. A study by San Francisco Federal Reserve economists Jonathan Neuberger and Gary Zimmerman found banks in California demonstrate uncompetitive pricing for deposits. California has long had intrastate branching and is highly concentrated, with four banks controlling almost 70 percent of the deposits. The study compared rates on several different deposit instruments from 1984 to 1987 and found California institutions had rates on money market deposit accounts and NOW accounts which were always below the national average. The same was true for certificates of deposit (CDs) of various maturities for 1985–1987.[7]

Federal Reserve economists Berger and Hannan found in their 1988 study, that banks in the most concentrated markets paid money market rates 25 to 100 basis points below banks in the least concentrated market. The findings were constant even after being corrected for time, size of market, and other variables.[8]

Because concentration can create these devastating anti-competitive effects, any proposal which addresses interstate branching should adequately address concentration concerns. *Title III of S.543 does not do this.*

Title III of S.543 imposes a cap on concentration. Specifically, S.543 would bar the Federal Reserve from approving an acquisition which would leave the acquiring bank in control of 25 percent or more of the insured depository institution deposits in the State. This cap is much higher than many State concentration caps. Moreover, the legislation allows the State to waive the cap *without* a provision requiring the State to assess the anti-competitive effects of such a waiver.

Most important, a 25 percent concentration level cap on market share of deposits on a Statewide basis is a relatively meaningless assessment of concentration for several reasons.

First, the monopolistic effects of a concentration occur within *markets* and not within the arbitrary geographic boundaries of a State (although the laws of a particular State may create incentives for the delivery of certain products). Therefore, any review of concentration must occur on a market by market basis, not on a State by State basis.

Secondly, deposit-taking is not the only "product" that banks offer. Banks offer loans, lines of credit, transaction accounts, working capital term loans, and cash management services. Retail banking products include transaction accounts, savings accounts, home mortgages, home equity loans and personal loans.[9] When the Justice Department evaluates the anti-competitive effects of a merger, analysis of deposit market share is a mere starting point. Analysis of anti-competitive effects of bank mergers are much broader and include careful investigation into the interplay between markets, products, and customers—both business and individual.

If the committee truly wishes to address the anti-competitive effects of interstate branching, legislation should require an examination of all the relevant criteria for determining anti-competitive behavior. For example, in analyzing the anti-competitive effects of bank mergers the Justice Department looks at the following:

1. relevant geographic market definition
2. relevant product market definition
3. the degree of concentration in the relevant market and the increase in concentration that will result from the merger
4. the ease and likelihood of entry

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[5] Stephen Rhoades. "Evidence on the Size of Banking Markets from Mortgage Loan Rates in Twenty Cities," Board of Governors of the Federal Reserve System Staff Report 162, February 1992.

[6] Allen Berger and Timothy Hannan. "The Price Concentration Relationship in Banking," Board of Governors of the Federal Reserve System. 1988.

[7] Jonathan Neuberger and Gary Zimmerman. "Bank Pricing of Retail Deposit Accounts and 'The California Rate Mystery'," Federal Reserve Bank of San Francisco *Economic Review*, Number 2. Spring 1990.

[8] Supra note 6.

[9] See Letter from James F. Rill, Assistant Attorney General, U.S. Department of Justice, Antitrust Division, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, on BankAmerica Corporation's Acquisition of Security Pacific Corporation 2 (March 12, 1992) [hereinafter Rill Letter on BankAmerica Corporation.]

5. efficiencies generated by the merger[10]

In defining relevant geographic areas, the Justice Department generally examines whether individuals and businesses consider a proposed geographic market to be a reasonable place for them to shop for financial services in terms of competition. Furthermore, the Department of Justice delineates between markets on a product by product basis. Ultimately, Justice may settle on different geographic markets for different products. In her law review article in the *Anti-Trust Law Journal*, Yvonne Quinn describes this well:

> In the Society-Ameritrust merger, the Department of Justice defined a relevant geographic market for loans to small businesses (defined as businesses with $10 million or less in sales) to be limited to a single county within the Cleveland, Ohio, metropolitan area, while apparently using the broader area to analyze retail and other commercial products and services.[11]

In his letter to Alan Greenspan, assistant Attorney General James Rill described the extensive investigation on the anti-competitive effects of the merger between BankAmerica and Security Pacific. He wrote:

> During the course of that investigation, the Department interviewed officers and employees of the parties, other banks and thrift institutions in the affected geographic areas and elsewhere, business customers of banking services, and non-bank suppliers of products and services supplied by the merging banks among others.[12]

Clearly, Title III of S. 543 has only a cosmetic approach to addressing the very serious impact of over concentration. The proposal must be revisited to articulate a much better mechanism for oversight and regulation. Moreover, it should be understood that without geo-coding of commercial and industrial loans, it is more difficult for regulators and investigators to determine true concentration levels. Once again, we must reiterate, that reporting requirements for commercial loans, along the lines of the Home Mortgage Disclosure Act requirements, would assist everyone in the process of assessing the anti-competitive effects of interstate bank acquisitions and branches.

## VI. Loss of State Enforcement Power and State Consumer Protection Laws

The power of States to enact and enforce consumer protection laws and fair lending laws has been significantly eroded in the past ten years. According to a CRS memorandum on Federal preemption of State consumer protection laws, "attempted application of the State regulation to Federally chartered banks and thrifts, has frequently met with opposition from affected institutions or Federal regulators asserting Federal preemption as a constitutional bar."[13] Congress should not impede the ability of States to protect their own citizens.

Currently, there can be considerable confusion about which laws govern interstate banks. Even though Title III of S. 543 articulates that national and State bank branches must be governed by laws of the host State, it is unclear as to whether transactions which occur in those branches are governed by the host State or by the State from which the transaction is derived. For example, a customer opening a checking account in State A, receives her bank statements from State B. Even though she opened her account in State A, is the transaction deemed to occur in State A or State B? Title III of S. 543 is not clear on this point.

Title III specifically says that national and out-of-State bank branches will have to comply with fair lending, community reinvestment, consumer protection, and intrastate lending laws as if they were a branch of a bank chartered within that State. However, this careful enumeration of categories leaves out important areas of the law—such as bank powers. Currently, many States give State-chartered institutions additional powers that others don't have—such as the ability to underwrite or sell certain products. With interstate branching, a banking organization interested in expanding its activities and expanding geographically will simply convert all its bank subsidiaries into one huge bank chartered by a State with liberal laws regarding bank activities.

Moreover, Title III of S. 543 does not adequately address *enforcement* issues. The only enforcement of State laws mentioned in the bill—applicable to interstate

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[10] Yvonne S. Quinn. "Practical Aspects of Defending Bank Mergers Before the Federal Reserve Board and the Department of Justice." *Anti-Trust Law Journal*, p. 95 [Vol. 62, 1993].

[11] Id, at 99.

[12] Rill Letter on BankAmerica Corporation, p. 2.

[13] Charles V. Dale. "Federal Preemption of State Consumer Protection Laws as Applied to National Banks and Other Federally Chartered Banking Institutions," *CRS Report for Congress*, March 12, 1992.

branches of State banks—address specified powers of the host State bank supervisory or regulatory authority. This appears to be a potential limitation on two enforcement activities: law enforcement activities by other State officials such as the Attorney General; and enforcement by State banking officials or other officials on matters *other than* those specifically enumerated, i.e., community reinvestment, fair lending, consumer protection and intrastate branching. Furthermore, there appears to be no enforcement authority for local State officials regarding interstate branches of *national* banks. Finally, the powers State enforcement authorities have over interstate branches should be exactly equivalent to the powers these authorities have over local banks; in other words these powers should not be limited to examination and enforcement. The powers might include investigation, assessment of fees, etc.

## VII. Concerns About the Safety and Soundness of Interstate Branching

In addition to problems enumerated above, geographic deregulation can pose safety and soundness problems to those banks that engage in interstate branching. Simply put, banks with geographically diverse portfolios and diverse products can be difficult to manage. Even some industry leaders contend that geographic expansion will lead to riskier, not safer institutions. John Medlin, chairman and chief executive of First Wachovia stated that interstate branching would allow banks to "replicate shaky underwriting practices on a larger scale." [14]

Economists Stephen Rhoades and Nellie Liang's study, *Geographic Diversification and Risk in Banking*, revealed that diversified banks were more likely to have lower levels of capital and profitability.[15] These management difficulties have led to some of the most notorious problem banks.

In his review of interstate banking, *Too Big to Fail, Too Few to Serve*, George Washington University law professor Arthur Wilmarth cites different examples of the hazardous effects of geographic diversification. He writes:

> Seafirst and Continental Illinois were driven to the brink of disaster by their purchase of large participation in high-risk Texas and Oklahoma energy loans made by Penn Square Bank.
>
> In recent years, Citicorp, Security Pacific, and First Interstate incurred substantial losses in connection with loans and other investments made in domestic markets outside their headquarters; cities and in foreign markets. Citicorp is the largest and most diversified U.S. bank, yet in late 1991 it had the lowest capital ratio and one of the highest levels of nonperforming assets and loan charge-offs among major U.S. banks.[16]

The Bank of New England is another example of the perils of geographic diversification. In 1982, the Bank of New England consisted of 87 branches in Massachusetts. By 1988, it was a multistate operation with 574 offices. Despite this rapid growth and geographical dispersion, when Bank of New England failed in 1991, its losses in Florida probably exceeded its losses in Boston.[17]

Clearly geographic diversity can take its toll on bank balance sheets. Subsequently, the need for capital can cause bank management to call perfectly good business loans and begin "draining" a community. To avert these two undesirable consequences, insolvency and draining, any proposal which allows interstate branching should only allow the most well-capitalized institutions to consolidate and branch. *Title III of S. 543 however, does not take this basic precaution of limiting interstate branching to well-capitalized institutions.* Under Title III of S. 543, institutions which are "adequately capitalized"—one step away from "under-capitalized"—can engage in interstate branching.

Allowing adequately capitalized institutions to engage in consolidation and branching may seem precaution enough. However, as the GAO has often noted, capital is a "lagging indicator" of the health of an institution. It is possible for a bank to have internal control problems that have not yet affected capital levels. Expansion for such organizations could allow potential problems to grow, later causing the failure of the institution. Raising the threshold from "adequately capitalized" to "well capitalized" will help offset unforeseen difficulties.

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[14] Steve Klinkerman. "Wider Branching Welcomed But Seen as No Quick Fix," *American Banker*, p. 1. June 28, 1993.

[15] Nellie Liang and Stephen Rhoades. "Geographic Diversification and Risk in Banking," 40 *Journal of Economics & Business* (1988).

[16] Arthur Wilmarth. "Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks," p. 985. *Iowa Law Review*, Vol. 77, No. 3. March 1992.

[17] Martin Mayer. "Too big not to fail," *Forbes*, p. 68. April 15, 1991.

CONCLUSION

We remain highly concerned about the impact geographic deregulation will have on consumers, taxpayers, local communities, and underserved sectors of the economy. In the event of interstate branching, strong evidence points to increased draining, disinvestment in local communities, branch closures, increased concentration, loss of State governing and enforcement authority, and problems of safety and soundness. Moreover, upon close examination of Title III of S. 543, we find that the bill does not address these concerns, and it is unclear and inadequate in many other ways as well.

We urge the committee to conduct further research on the impact interstate branching will have on local communities and the economy as a whole. Furthermore, we *strongly* urge the committee to pass legislation which will require disclosures for commercial and industrial loans along the lines of the HMDA data disclosures to aid in current and future assessments of community reinvestment and concentration studies. Finally, if the committee decides to take up Title III of S. 543, we strongly urge that it be thoroughly rewritten to address the concerns we have raised.

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## PREPARED TESTIMONY OF BALLARD W. CASSADY, JR.

### EXECUTIVE DIRECTOR OF THE KENTUCKY BANKERS ASSOCIATION

NOVEMBER 3, 1993

Mr. Chairman and Members of the committee, I am Ballard W. Cassady, Jr., Executive Director of the Kentucky Bankers Association (KBA). The KBAs' member organizations range in size from $1 million in total assets to $6 billion. Seventy-seven percent (77 percent) of Kentucky's banks are below $100 million in assets. The combined assets of our members comprise over ninety-nine percent (99 percent) of the total assets of commercial banks in Kentucky. This year I will also have the honor of serving as Chairman of the State Banking Associations group with the responsibility of representing my colleagues across the country.

I appreciate the opportunity to testify before this committee on nationwide banking and branching and other provisions contained in Title III of S. 543 which was passed by the Senate in November 1991. They are issues on which bankers all across the country have very strong opinions.

First let me state that the Kentucky Bankers Association led an effort in 1991 along with 29 other States, plus Puerto Rico, to help pass the provisions contained in Title III of S. 543 concerning "interstate banking and branching by acquisition only." The support from State banking organizations came from a wide variety of States with a diversity of banking structures. The support came from many small States, but also big States such as California, New York, and Texas. Our coalition included southern States such as Alabama, Tennessee and North Carolina, midwestern States like Illinois and Missouri, northeastern States like Massachusetts and Connecticut, mid-Atlantic States like Maryland, and western States such as Washington. I think we had significant input from all elements of the industry, and from every part of the country.

We have been encouraged by the position taken thus far by the Clinton administration supporting interstate banking reform, which includes the four principles of promoting efficiency and competition, protecting safety and soundness, meeting consumer and community needs, and respecting the interests of the States. In our view, the current Ford Bill, S. 810, is based upon each of these principles and most effectively satisfies the goals of the administration and is virtually identical to what the Senate passed in 1991.

Maybe the best statement to start with is actually a question. Why did so many State bank associations support the Ford Amendment in 1991 and still support it through S. 810 today? The answer is relatively simple—the Ford Amendment was the near perfect compromise. It allowed those institutions who sought growth through expansion the opportunity to do so by acquiring existing institutions and at the same time allowed those who wished to stay local community banks to do so by "just saying no" when an acquisition offer was made. The Ford Amendment protected the banks legitimate franchise interest by not allowing de novo branching except in those States, which by statute, expressly permitted it. It also allowed those States who did not want to participate in *any* type of interest branching to "opt-out."

Once an acquisition was made it could be converted to a bank of the "home office" but, all future branches (Intrastate Branching) were subject to existing State laws.

Thus it meets the parameters laid out by the Clinton administration before this committee earlier today and in the corresponding committee in the House earlier last week.

After working with the Conference of State Banking Supervisors and the Multi-State Tax Commission, the Ford Amendment attempted to allow for taxation by each State as long as it was not discriminatory. It called for compliance with the Community Reinvestment Act (CRA) as well as a host of other consumer oriented banking regulations.

In essence, the provisions contained in the Ford Amendment in Title III of S. 543 are also present in S. 810.

We believe that this bill strikes a balance where there is a need to update Federal statutes while still respecting the rights of States and the legitimate franchise interest of small community based lending institutions.

The dual banking system has worked well and should be allowed to continue. In my opinion provisions such as those contained in S. 810 foster the dual banking system while allowing certain market trends to progress. Currently, every State but one (Hawaii) has legislation allowing some type of interstate banking and well over two-thirds permit full interstate banking. Interstate banking is a reality in today's market place. The next logical step is to allow those bank holding companies to consolidate their acquisitions into branches of the "home office" thereby allowing the "Economies of Scale" to take place. Under Title III of S. 543 and S. 810 each State would still maintain the ability to "opt-out" of those provisions if they so desired. For those States who wanted to go even further they could expressly "opt-in" to de novo branching. So, Mr. Chairman, as you can see Title III of S. 543 protected the rights of States not only with the "opt-out" and "opt-in" provisions but also with respect to regulation, taxation and enforcement of its laws as does S. 810.

In my view Mr. Chairman, any interstate banking or branching law that is passed by the Senate should not only protect States' rights but also offer some degree of protection to the legitimate franchise interest of small, community-based banking institutions.

We have all heard fears expressed that interstate banking and branching by acquisition would hurt smaller communities through the loss of service to that community by those callous multibank holding companies. I cannot agree with this argument for two reasons.

*First*, the consumer will go where they get the service and they will take their money with them! Innovation and market void penetration was invested by Americans therefore, if the larger banks are not servicing the small communities you will see a proliferation of new bank charters to fill that service void.

*Second*, as pointed out by comptroller Ludwig before the Subcommittee on Financial Institutions Supervisions Regulation and Deposit Insurance in the House of Representatives last week, "successful banks traditionally have been those that best meet the needs of the market they serve." Large banks have adapted somewhat but, small community banks have excelled at personalized service when needed, especially in loaning to small business. That is where knowledge of borrowers and local credit conditions are major factors and more likely to be possessed by the smaller community bank.

This statement is contingent on the Government making new charters accessible under reasonable guidelines and also contingent upon the Government realizing the different regulatory needs between the two types of institutions. (Example: Community Reinvestment Act (CRA) requirements and guidelines should be much different for rural communities than they are for urban areas).

Under Title III of S. 543 and in S. 810 the only way banks could enter a State is through acquisition and after they had entered a State any further branching would be determined by State law. Title III and S. 810 would also allow the conversion of those acquisitions into branches of a "home office," unlocking the potential for cost-savings.

I have attached for your review Exhibit A which outlines the *Essential Traits of Interstate Banking Reform* that are sought by the majority of State banking Associations. S. 810 is the best compromise available.

It seems we cannot talk about this issue without talking about foreign bank participation. With that assumption, I cannot help but to maintain an area of grave concern to our bankers, the concentration of assets and favorable treatment of non-U.S. banks operating in this country and through off-shore shells. I was totally taken by surprise when Federal Reserve governor LaWare testified before this committee a few weeks ago (Oct. 5, 1993) saying in essence, he did not feel that foreign banks were receiving national treatment under S. 543 and that foreign banks should receive "parity of treatment in their interstate operations." I would say to the members of this committee that I only *wish* foreign banks had parity of treatment with

U.S. banks. Currently they receive treatment more *"preferential"* than national treatment. As a former small town bank president and a former commissioner of banking for Kentucky, I have always been amazed at how foreign banks were given a competitive edge when compared with U.S. banks.

By Congress' own definition National Treatment is defined as:

"A foreign bank operating in a particular nation should be accorded operating privileges which provide such banks with the opportunity for competitive equality with their host country . . ."[1]

What the foreign bank industry in the U.S. has been enjoying far exceeds national treatment. Let me give you some concrete examples:

Foreign banks operate in the U.S. in several ways. As of June 1992, they own 98 separately chartered U.S. bank subsidiaries, they also operate 390 full-service branches, and 225 agencies. They operate 253 "representative offices" which solicit and gather new lending business. Their remaining operations represent 15 international financing vehicles known as Edge Act Corporations and 8 subsidiaries chartered under New York law as business lenders. In all, 302 banks from 62 countries operate banking offices here with projected assets of $899 billion. They make almost 36 percent of all commercial and industrial loans; 18.5 percent of commercial real estate loans and control 21 percent of all U.S. banking assets.—That is until you take into consideration their off-shore branches principally in the Bahamas and Cayman Islands.[2]

Foreign banks have for years provided U.S. residents banking services booked in their offshore offices through their branches located in the U.S. Since States and localities tax foreign bank U.S. activities they have an added incentive for booking their transactions offshore. Before March of 1993, data on these types of transactions were sketchy at best.

As of January 1993 the Federal Reserve on behalf of the Federal Financial Institutions Examination Council has been gathering information on the offshore activities of non-U.S. banks that have *related* U.S. offices.

The new data shows that as of March 1993, assets and liabilities of offshore non-U.S. bank branches amounted to $379 billion, almost two-thirds (or $219 billion) of the total reported assets were claims on U.S. residents. If you add the new data on offshore activities to existing data on branches and agencies you increase total U.S. assets held by foreign banks to over $1 trillion or almost 25 percent of America's total banking assets. Their share of commercial and industrial loans increases from 36 percent to almost 42 percent. Their share of commercial real estate loans increases from 18.5 percent to over 20 percent.[3]

Why and how is this kind of dominance able to take place over U.S. banks in this country? Quite simply foreign banks have major competitive advantages in pricing loans and deposits over U.S. banks. First, many foreign banks are not subject to Glass-Steagal and can do both commercial and investment banking in the same institution in our country. Secondly, the cost of capital to U.S. banks is increased significantly through compliance with numerous regulations not imposed on foreign banks. Foreign banks conduct most of their activity in this country through branches of their main bank headquartered abroad. These branches do not pay deposit insurance premiums, they are not subject nor involved in any Community Reinvestment Act requirements, nor are they subject to a host of consumer statutes like those American banks are subject to.

In addition, they may not be required to keep capital in their headquarters equivalent to what American banks need to operate in this country (i.e., Japanese banks can count unrealized gains in equity stocks as capital, a privilege not offered U.S. banks). The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) added a new subsection to the International Banking Act of 1978 which requires foreign banks to take insured deposits in subsidiary banks incorporated in this country, rather than in direct branches of foreign banks. However, regulations promulgated by the OCC and FDIC permit foreign banks to accept certain types of "non-retail," uninsured deposits of less than $100,000 in their wholesale branches. They pay no deposit insurance premium on those deposits thus allowing them to pay higher rates for corporate deposits, not to mention they are exempt from deposit insurance on retail deposits over $100,000 (FBSEA–91).

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[1] Congressional Research Service. The Library of Congress: "Foreign Banking in America: Growth and Regulation." William Jackson, June 8, 1993 (93–581E).

[2] Congressional Research Service. The Library of Congress: "Foreign Banking in America: Growth and Regulation." William Jackson, June 8, 1993 (93–581E).

[3] Federal Reserve Bulletin: "U.S. Branches and Agencies of Foreign Banks: A New Look." Henry Terrell: October 1993.

Last week you heard testimony from the Treasury Department concerning their future efforts to insure that U.S. banks operating abroad will have equal access to foreign markets. As this committee knows, Chairman Riegle and Senator D'Amato have long advocated such a stance by the Treasury Department. I applaud this long over-due initiative as well; however, I suggest this committee also examine why we are giving foreign banks operating in this country advantages over U.S. banks thus aiding their ability to expand their U.S. market share. The Federal Reserve seems not to be interested in efforts to insure U.S. banks receive "national treatment" abroad. However, it seems they spend their efforts to advocate parity of treatment here for foreign banks, the whole while ignoring the competitive advantages they already enjoy in this market.

In conclusion, I would like to say that we support S. 810 which contains all of Title III of S. 543 which passed the Senate in 1991 and would suggest that this committee go one step further to offer competitive equality to U.S. banks with their foreign counterparts located here in the U.S.

EXHIBIT A

## ESSENTIAL TRAITS OF INTERSTATE BANKING REFORM

### Interstate Banking by Acquisition

This trend is already a reality. Federal law should provide for nationwide interstate banking by acquisition. State laws setting the "age" of banks to be acquired will be respected. State laws regarding intrastate branching and community reinvestment will continue in effect.

### Interstate Branching by Combination/Opt-Out

Combinations of bank holding company subsidiaries in two or more states should be available on an opt-out basis. A middle ground proposal would advance this activity, giving the states the right to opt-out if they DO NOT WANT interstate branching by consolidation. State laws regarding intrastate branching, community reinvestment, consumer protection, and fair lending will continue in effect.

### Interstate Branching De Novo/Opt-In

De novo branching should be available on an opt-in basis.

Already, there are about 12,000 banks nationwide. De novo branching may lead to an undesirable proliferation of banking outlets and negative consequences, at least in the short-term. De novo branching also directly threatens the legitimate franchise interests of small, community banks.

A middle ground proposal should not prohibit de novo branching altogether. Rather, it should give the states the right to opt-in if they WANT de novo branching by passing a law on the state level.

### Foreign Bank Branching

Foreign banks should not be discriminated against with respect to interstate banking and branching. Neither should U.S. banks. States which allow interstate activity for U.S. banks should provide the same rights for foreign banks, so long as those foreign banks are subject to the same laws with respect to deposit insurance, intrastate branching, community reinvestment, consumer protection, fair lending, and other areas associated with U.S. chartered institutions.

### Respect for States' Rights

What happens under the aforementioned approach if a state takes no action whatsoever? it has a reasonable, middle ground policy on interstate banking and branching. Nationwide interstate banking by acquisition will be allowed. Nationwide interstate branching through consolidation will be allowed. Interstate branching de novo will not allowed. The franchise interests of small, community banks will be protected. State laws setting the "age" of banks to be acquired will be respected. State laws regarding intrastate branching will continue in effect.

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

May 19, 1992

The Honorable Charles A. Bowsher
Comptroller General of the United States
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

As you know Congress continues to consider the many issues associated with interstate banking and branching. To assist us evaluate these issues, I would appreciate your reporting to the Committee on the impact of the proposed changes in state and federal laws regarding interstate banking and branching on:

1. the safety and soundness of the commercial banking industry;

2. concentration in, and the structure of, the banking industry;

3. the availability, price, and flow of credit, with particular focus on regions of the country now reporting a credit crunch;

4. the dual banking system and the ability of states to apply consumer and community reinvestment laws to other states' and national banks, and to tax those banks;

5. the ability of U.S. banks and their business customers to compete abroad.

I would also appreciate your views on how interstate banking and branching should be supervised by the regulators, whether our supervisory apparatus is currently adequate, and whether the current consolidation, which is already underway, is taking place in a responsible, organized manner. Please feel free to address these issues and any others you may wish to review as you see fit.

The timing of legislation on interstate banking is unclear, but I anticipate that this issue will be taken up early in the next session of Congress, if not before. I request, therefore, that you plan to complete this work when it is likely to be needed -- no later than February 1993. In addition, please hold your staff prepared to brief the Committee staff on your work in the event that this issue is taken up during the remainder of this session.

If you have any questions on this request, please contact Gillian Garcia of my staff at 224-2337.

Sincerely,

Don Riegle

Donald W. Riegle, Jr.
Chairman

DWR/ggg

GAO United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-253437

November 2, 1993

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

Your May 19, 1992, letter requested that we report on the impact of proposed changes in laws concerning interstate banking and branching. This report responds to your request.

As arranged with the Committee, unless you announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to all Members of the House Banking Committee as well as other appropriate congressional Committees, federal banking agencies, and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of Stephen C. Swaim, Assistant Director, Financial Institutions and Markets Issues. Other major contributors are listed in appendix IX. If you have any questions, please call me on (202) 512-8678.

Sincerely yours,

James L. Bothwell

James L. Bothwell
Director, Financial Institutions
and Markets Issues

# Executive Summary

## Purpose

The United States is the only major industrial country that places geographical restrictions on its banks. Many industry observers have called for removing or relaxing these restrictions, and bills currently are pending to do this. To assist in its evaluation of this issue, the Senate Committee on Banking, Housing, and Urban Affairs asked GAO to provide information and analysis on the effects of interstate banking and branching.

This report concentrates on the following three areas: (1) the impact of interstate banking on the structure of the banking industry; (2) the implications of removing interstate banking and branching laws on the safety and soundness of the banking industry, the Bank Insurance Fund, and the economy; and (3) the risks associated with removing interstate banking and branching laws and ways to minimize such risks.

## Background

Historically, banks in the United States have been restricted from expanding geographically because of concerns that such expansion would depersonalize banking relationships, drain savings from local economies, and result in excessive concentrations of economic power. Such concerns are, in part, why the banking system in the United States is composed of over 11,000 banks. These banks operate either under national charters granted by the Comptroller of the Currency or under charters granted by states.

Banking companies can expand geographically either by establishing bank branches or subsidiaries. Bank branches are offices of the bank and, as such, do not have separate capital requirements. Bank subsidiaries are separately chartered and regulated institutions that are part of bank holding companies. In addition to bank subsidiaries, bank holding companies consist of a parent and often some nonbank subsidiaries, such as thrifts, finance companies, mortgage companies, and data processing firms.

Current law permits in-state branching in most states but effectively precludes interstate branching for national banks and almost all state-chartered banks. The McFadden Act of 1927 allows national banks to branch throughout their home states if the states permit branching by their own banks. However, the act generally prohibits interstate branching for national banks and for all state-chartered banks that are members of the Federal Reserve System. Together these banks account for about 74 percent of the banking industry's assets.

State law governs interstate branching by state-chartered banks that are not members of the Federal Reserve; with a few minor exceptions, no interstate branching has been allowed to date. All but 13 states allow both national and state-chartered banks to branch freely within their states, but only a few states permit branching across state lines.

Banking companies can use the bank holding company structure to avoid the restrictions placed on branching and expand their interstate operations by acquiring banks in different states. However, this type of expansion is also subject to federal and state restrictions. Specifically, the Bank Holding Company Act of 1956, through a provision known as the Douglas Amendment, prohibits bank holding companies from establishing or acquiring a bank in another state unless such action is specifically permitted by the state the bank holding company wants to enter. And almost every state, to some degree, has restrictions or conditions that govern this type of interstate banking.

Recent legislative proposals have focused on relaxing or removing these interstate banking and branching restrictions. Supporters of a nationwide interstate banking and branching law argue that these restrictions no longer make sense in today's integrated financial and credit markets. Restrictions, they contend, limit American banks from competing with foreign banks, pose greater risks to the banking system and the Bank Insurance Fund (because they limit the extent to which banks can diversify), reduce competition within the industry, and increase consumer costs because of inefficiencies. Those who oppose geographic expansion or support limited expansion believe that increased interstate banking will lead to excessive concentrations of economic power and adverse effects on banking customers and local economies.

## Results in Brief

Many states have relaxed their restrictions on interstate expansion of bank holding companies, and much interstate banking is occurring as a result. Removing federal interstate banking and branching restrictions would further encourage the growth of larger, more geographically diversified banking companies. The extent to which interstate banking would increase as a result of passing a nationwide interstate banking and branching law would depend on the extent to which state banking laws are overridden, the strategic business decisions of bankers, and the actions of state and federal regulators.

Increased interstate banking is leading to increased concentration of assets at the national level as large banking companies continue to acquire or merge with banks in other states. Concentration of assets at the state and local levels, however, increases only as a result of mergers and acquisitions among banks that are in the same states or local markets. Banks with assets of less than $1 billion have been able to maintain their national market share despite the growth in the size of the largest banking companies.

Removing interstate banking and branching restrictions could benefit the safety and soundness of the industry, the regulatory process, and many bank customers. However, removing such restrictions poses risks as well. Problems can arise if banks are not well managed and well regulated, concentration levels of assets increase significantly, or credit availability is reduced to those bank customers whose borrowing needs are not easily met elsewhere.

The risks to safety and soundness can be minimized by restricting interstate expansion to well-managed and well-capitalized banks and by properly implementing the early closure and safety and soundness provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991.

The best way to minimize the risks to the quality and availability of banking services is to ensure that markets remain competitive through vigilant antitrust enforcement and that laws and regulations governing credit availability are adequately enforced. Additional regulatory authority may be needed to address any unanticipated consequences resulting from increased interstate banking.

## GAO's Analysis

Over time, the relaxation of restrictive state banking laws has contributed to a substantial increase in the amount of interstate banking in the United States. Almost 25 percent of the country's $3.5 trillion in banking assets are held in out-of-state subsidiaries of domestic banking companies and foreign-owned banks. However, differences in state banking laws have contributed to considerable state-by-state variation in the extent of out-of-state ownership. In 16 states plus the District of Columbia, more than 40 percent of each of the states' bank assets are owned by banking companies headquartered out of state. By contrast, in 13 states, less than 10 percent of each of the states' bank assets are owned by out-of-state banking organizations. (See pp. 48-51.)

## Impact on Market Structure

Increased interstate banking has contributed to a substantial consolidation of the U.S. banking industry and led to an increase in overall industry concentration. From December 1986 to December 1992, the number of independent banking companies in the United States declined almost 20 percent, from 10,620 to 8,794, while the percentage of banking assets controlled by the 3 largest banking companies—a measure of overall industry concentration—increased from 12.8 percent to 14.4 percent. (See pp. 27-30.)

There is no direct relationship between increased interstate banking and changes in the state and local concentration levels of the three largest banking companies. Between 1986 and 1992, those concentration levels increased in 32 states but declined in 7 of the 16 states with the highest proportion of out-of-state ownership of banking assets. The average concentration levels of the three largest banking companies in local banking markets did not change between 1980 and 1991. (See pp. 57-62.)

Increased interstate banking does not necessarily mean a reduced role for smaller banks. Between 1986 and 1992, banks with assets of less than $1 billion, measured in 1992 dollars, maintained a national market share of about 20 percent and increased their market share in 9 of the 16 states with a relatively large amount of interstate banking. However, these banks have no guarantee of a stable or expanding market share. Their continued viability will depend on such factors as their abilities to serve their communities, the efficiency of their management, their desire to remain independent, and the acquisition strategies of larger banks. (See pp. 62-67.)

## Safety and Soundness Implications

Interstate banking and branching can provide opportunities for individual banking companies and the banking system as a whole to benefit from reduced costs, expanded market opportunities, and greater diversification of risks. However, the extent of these benefits and whether they will improve a banking company's performance will depend largely on how well the banks are managed. The safety and soundness of large interstate banking companies are of particular importance because the failure of such banks could seriously harm the Bank Insurance Fund and local economies. The risk of such harm would be minimized if interstate expansion is restricted to well-capitalized and well-managed banks. (See pp. 74-77.)

One potential benefit of nationwide banking and branching is that it may help reduce deposit insurance costs by enabling more banks to acquire weak or failing banks before they actually fail. Another benefit is that banking companies can become stronger by increasing the geographical diversification of their assets and liabilities, while reducing the cost of such diversification as a result of a more simplified banking structure. Increasing core deposits by expanding geographically could also lower banks' funding costs and reduce susceptibility to runs. It is not possible to generalize how interstate branching, by allowing interstate bank holding companies to convert bank subsidiaries into branches, would affect the holding companies' net income. Some bank holding companies have estimated that interstate branching would create potential cost savings equal to about 4 percent of net income. (See pp. 77-79.)

The complicated organizational structures of bank holding companies that have occurred in part because of the existing restrictions on interstate branching also require supervision by a large number of federal and state regulatory agencies. If banks could establish branches across state lines, their bank holding companies could consolidate their operations and reduce the number of their bank subsidiaries. If as a result, the number of different bank charters in a bank holding company declined, then fewer regulatory agencies—and perhaps fewer bank examiners as well—would be responsible for overseeing the subsidiaries of a particular holding company. In addition, because many bank holding companies are already centrally managed, simplifying their organizational structures could enable examiners to more easily assess risks for the holding company as a whole. (See pp. 93-99.)

GAO previously has identified regulatory delays in addressing known bank problems, problems with bank management and internal controls, and weaknesses in large bank and bank holding company supervision. These problems should be addressed before any relaxing of federal interstate banking restrictions occurs. In particular, proper implementation and enforcement of the early closure and other safety and soundness provisions in the Federal Deposit Insurance Corporation Improvement Act of 1991 is vital to ensuring that additional industry consolidation does not strain the resources of the Bank Insurance Fund. (See pp. 91-92.)

## Implications for Bank Customers and Local Economies

Many bank customers—commercial and retail—could benefit from interstate banking and branching as a result of (1) the wider range of products and services typically offered by larger banking companies;

(2) the reduced need to maintain separate accounts for customers who bank across state lines; and (3) the improved accessibility of banking offices. However, not all customers would benefit from such changes. Some communities and small businesses could experience disruptions in established lending relationships when local banks are acquired by out-of-state companies. (See pp. 102-104.)

Concerns have also been raised that interstate banking and branching could harm local economies if large, interstate banks use deposits from local areas to fund loans in other parts of the country. Although some communities could experience temporary disruptions in credit relationships when there are changes in local bank ownership, the movement of funds within the country is essential to the functioning of a dynamic economy. GAO found no basis for concluding that interstate banking would systematically result in the diversion of funds from creditworthy local borrowers, as long as credit markets remain competitive. (See pp. 108-113.)

## Regulatory Oversight Needed

To help prevent potential problems from increased interstate banking, the antitrust statutes as well as those laws and regulations concerning credit availability must be enforced vigilantly. Although relevant economic markets are often difficult to define, effective antitrust enforcement in bank mergers is essential to ensuring that markets continue to operate competitively. As half of the nation's 318 metropolitan areas are already dominated by 3 or 4 banks, oversight of antitrust enforcement will be necessary regardless of whether federal interstate banking restrictions are removed. (See p. 126.)

For competition to exist, it is also important that entry into the banking industry through new charters should not be inhibited by excess regulation or other high costs. New entry increases the likelihood that competition will exist to provide credit and meet other banking needs that might otherwise go unfulfilled amid consolidation. (See pp. 137-140.)

There is widespread concern that some banking needs—particularly the credit needs of low-to-moderate income borrowers—are not being adequately met even in competitive markets. The Community Reinvestment Act of 1977 addresses this concern by requiring banks to help meet the credit needs of their communities. How a bank is judged to perform its responsibility under this law is an important consideration in the merger approval process and can help improve any potentially adverse

consequences of bank consolidation on credit availability. Currently, a bank is given only one performance rating for all of its operations. Unless these rating requirements are modified, interstate branching would make it more difficult to assess a bank's lending performance in local communities if a bank's operations covered large regions or the entire nation.
(See pp. 120-123.)

## Recommendations

GAO is making no recommendations in this report.

## Agency Comments

GAO requested comments on a draft of this report from the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Department of the Treasury. The Federal Deposit Insurance Corporation and the Department of the Treasury provided written comments, which appear in appendixes VII and VIII respectively. The Federal Reserve and the Office of the Comptroller of the Currency did not provide us with written comments, but in discussing the report with us, they made technical comments, which have been incorporated where appropriate.

The Federal Deposit Insurance Corporation indicated that as a general matter it supports the relaxation of geographic and product restraints on banks, provided that the states continue to play a role in the transition. It pointed out that the Bank Insurance Fund has absorbed major losses in rescuing banking organizations with assets concentrated in a few industries or in a limited geographic area. Also, it stated that these banking organizations may have been better able to withstand the problems in their local and regional markets if they had been more geographically diversified. GAO addresses this issue in chapter 4 of this report.

The Department of the Treasury stated that it had no formal comments but found the report to be an impressive and thoughtful survey of the issues and evidence.

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

August 31, 1993

Honorable Eugene Ludwig
Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Dear Mr. Ludwig:

I am concerned about the increasing concentration now underway in the banking industry.

For example, some bank-holding companies now hold substantial percentages of their banking assets in one or more geographic areas. I would appreciate an analysis, with supporting data, of the degree of concentration currently in the banking industry.

- Do you believe that the increasing concentration of banking services has become, or is becoming, excessive?

- Has the concentration in banking services been a factor in the recent decline in commercial lending in some areas?

- Have states or MSAs dominated by out-of-state bank holding companies experienced greater declines in commercial lending than other areas?

- What degree of concentration would OCC regard as excessive?

Interstate banking bills, now before the House and the Senate, would limit a single bank holding company to no more than 10 percent of the nation's deposits and no more than 30 percent of the deposits of any state.

- Are these suitable constraints on concentration? Or would some other measure be preferable?

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I would be grateful if your staff would examine these issues with some urgency and report back to the Committee by January 1, 1994. If you have any questions regarding this letter, please have your staff call Gillian Garcia at 224-2337.

Sincerely,

Donald W. Riegle, Jr.
Chairman

DWR/ggg

COMPTROLLER OF THE CURRENCY
ADMINISTRATOR OF NATIONAL BANKS

NOVEMBER 1, 1993

THE HONORABLE DONALD W. RIEGLE, JR., CHAIRMAN
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Dear Chairman Riegle:

This is in response to your inquiry of August 31, requesting information about concentration in the banking industry. You specifically asked if resources were becoming excessively concentrated, if concentration was contributing to the decline in commercial lending, and if commercial lending had declined more in areas where a high proportion of banking resources are held by out-of-State companies. You also asked for reaction to proposed statutory deposit share caps as a mechanism to constrain concentration.

My economics staff has prepared a detailed report on these issues, which is attached, but I would like to summarize their findings.

*Is Concentration Excessive?*

Measures of concentration in the banking industry are imprecise; however, the available evidence suggests that concentration is not excessive. Even with the best of information, it is difficult to accurately identify all relevant competitors and to definitively measure their market shares. Different measurements show different pictures of market concentration. In addition, a given level of concentration may be of more or less concern depending on other market circumstances, most notably ease of entry. That is to say, concentrations are of less concern in a market that new participants can enter easily.

Most experts agree that banking involves a number of markets of varying sizes. Those markets are defined by type of product or service. Some markets, such as those for small business lending, are primarily local or less than Statewide in scope. Data suggest that local concentration is not disturbingly high or increasing rapidly, even in States where large out-of-State companies have been actively acquiring institutions. Because States' boundaries do not usually coincide with bank markets, an analysis of concentration on a Statewide basis is not likely to be particularly informative. Nonetheless, we looked at those figures to see if they yielded a different picture. They did not; Statewide concentration numbers also are not high and are not increasing rapidly.

*Has Concentration Contributed to Lower Commercial Lending by Banks?*

A State-by-State examination of the relationship between Statewide concentration and changes in commercial lending suggests concentration has not contributed to lower commercial lending by commercial banks. Again, it is difficult to definitively answer this question, but our analysis found that neither the absolute level of concentration nor the change in the level were strongly related to changes in commercial lending. States with high concentration or where concentration increased appeared no more likely to have experienced declines in commercial lending than other States.

*Has Commercial Lending Declined More Where Out-of-State Companies Dominate?*

Again, our analysis of historic data found no correlation between the decline in commercial lending and domination by out-of-State companies. When States were divided into two groups—those dominated by out-of-State holding companies and all others—changes in the level of commercial lending did not differ significantly between the two groups.

*Are State and National Deposit Share Caps an Appropriate Way to Constrain Concentration?*

There is virtually no theoretical or empirical evidence that concentration on a Statewide or national level has any adverse economic impacts. As discussed earlier, in an economic sense, most banking markets are geographically much smaller than the State or Nation.

From a theoretical point of view, limits such as those in the proposed legislation that apply a single, largely arbitrary standard to Statewide and nationwide concentration could be counterproductive. Such limits could protect inefficient banks from competition, constrain competitive banks from diversifying their operations, and hurt consumers by limiting their choice of service and price. Further, potential merge-related increases in concentration can be effectively addressed as they have been in the past—by existing antitrust law.

I share your concern that bank customers should get the best service possible in every market. As a matter of policy, however, the OCC is also concerned about regulations that constrain free functioning of the markets. Such regulations are acceptable only when they help overcome serious problems. At this point, our economic analysis does not find that concentration warrants such regulations. Safe and sound acquisitions do not appear to threaten the functioning of the market, reduce customer choice, or foster other anti-competitive behavior.

As you and your staff review the more detailed paper on these issues, my staff and I stand ready to answer your questions.

Sincerely,

Eugene A. Ludwig

## Implications of Recent Concentration Trends in Banking

This paper looks at the issue of concentration in the banking industry. After introducing the topic and different economic views, it addresses several current questions relating to concentration:

- Is concentration above a level where it becomes a concern?
- Has recent interstate holding company acquisition activity contributed to concentration?
- Is the recent decline in commercial lending by banks the result of concentration?
- Are caps on the percent of deposits a single institution could hold nationally or in its headquarters State necessary to alleviate concentration?
- Have acquisitions by out-of-State holding companies led to declines in commercial lending by banks?

This economic analysis finds that current levels of concentration are not excessive or increasing rapidly. Therefore, deposit caps seem unnecessary and could have a negative effect on some markets. There appears to be no significant connection between changes in commercial lending and concentration or interstate acquisition activity by bank holding companies.

### Background

Concentration has long been a matter of discussion in the economic analysis of industries. Concerns about concentration, or the extent to which a market is dominated by a few, large firms, stem largely from a belief that concentration limits competition and fosters collusion. Currently a number of observers are concerned about consolidation in the banking industry and believe it may result in "excessive" concentration.

Economists are generally divided on the issue of whether concentration in an industry gives cause for concern at some given level. In addressing this issue economists are divided into those—the structuralists—who believe that concentration may be a concern and those who are not concerned about concentration in a freely functioning market.

#### *Structuralist View*

The structuralist view is reflected in current antitrust policy. Structuralists believe that concentration determines the likelihood that competitors can successfully collude to control markets, even tacitly. They also believe it determines the intensity of market competition.

To study the effect of concentration, structuralists usually aggregate market shares of dominant firms into industry concentration indexes. They see empirical studies that find a correlation between concentration and prices or profits as support for their position.

#### *Responses to the Structuralist View*

In the empirical studies cited by structuralists, the effect of concentration on prices or profits usually is quite small. Some studies, in fact, show no effect. Most economists believe that other, unexplained, factors cause much of the variation in markets. Going even further, some economists believe the relationship between concentration and profits reflects market efficiency, not collusion. They say efficient firms earn high profits and gain market share and that the result is an increase in concentration. This view sees concentration as the result of good performance, not the guarantee of it.

Another criticism of the structuralist view relies on the idea that the level of concentration is less important in a market that allows new competitors to enter and old ones to exit freely. Proponents of the "contestable markets" theory believe that

easy entry and exit lead to markets that approximate perfect competition, even when concentration is high. They believe that differences in entry conditions are extremely important when assessing the competitiveness of a market.

### Measuring Market Concentration

Any standard for concentration must start with a measurement method and the establishment of an acceptable maximum, or "critical," level. Crucial to this process is the accuracy of the definition of the product and geographic scope of the market. Especially in banking, an analysis of trends and related performance implications of concentration should focus on developments in carefully defined product and geographic markets. Inaccurate definitions of competitors or scope will make market shares and concentration measures inaccurate.

Market definition in the real world is inevitably complicated, necessarily subjective and imprecise. Definitions are not static and can become obsolete because of changes in technology, tastes or regulation. Those changes have altered the way bank customers purchase financial services. Most, with the possible exception of small business borrowers, now typically "unbundle" their purchases. The geographic market for many bank products has also expanded in varying degrees. This suggests that informed statements about a bank's market power require careful analysis of the number and size distribution of actual and potential competitors in each of many sub-markets.

Knowledgeable observers may legitimately disagree about the definitions in general and in particular cases. This means that concentration measures also inevitably are imprecise and incorporate some amount of error.

#### *Defining Competitors*

In banking, competitors have been defined relatively narrowly in the past. Until recently, the product market was defined to be "commercial banking," because commercial banks offered some unique products (transaction accounts and commercial loans) that other financial services providers could not. As a result, non-commercial bank entities, including savings and loan associations (S&L's), were not considered effective competitors because they could not offer the same "cluster" of services, and were ignored in bank antitrust analysis. Further, this was the justification for looking at concentration in terms of a single bank product (deposits) rather than multiple products.

Once S&L's were allowed to offer essentially the same bundle of products as commercial banks, bank regulators and the Department of Justice (DOJ) began to consider them as at least partial competitors in bank merger analysis. The *ad hoc* approach generally used by the Federal Reserve Board is to include S&L deposits when calculating market concentrations in bank mergers but to give them a 50 percent weight (as opposed to the 100 percent weight applied to deposits of commercial bank competitors). That lower weight presumably reflects a lower competitive strength.

Sometimes the importance of a competitor may not be reflected in its current market share. In banking, the classic example of this is an organization that is large in absolute terms, but that has only a small presence in some particular product or geographic market. In this case, the organization's market share for that product or service will tend to understate its competitive impact.

Even in carefully defined markets, allowances should be made for the effects of competitors that may not be adequately reflected in the calculated concentration statistics.

#### *The Importance of Entry*

In bank antitrust analysis, the area in which concentrations are most often discussed, entry conditions should be considered because legislative, regulatory, technological, and preference changes have greatly increased the number of potential and actual competitors for bank products and services. Although only imprecise identification of potential entrants and their likely competitive impact is possible, recent research indicates there was considerable entry during the 1980's in response to the substantial branching liberalization. Further, entry can be expected to continue as a pro-competitive force in the future.

#### *Defining Markets*

Geographic markets have also been drawn quite narrowly in bank antitrust analysis. They have been defined to be local because some bank customers presumably cannot or will not be able to switch to non-local suppliers in response to anti-competitive price increases. Generally, this means the market is considerably smaller than Statewide. By convention, it approximates the county in rural areas and the metropolitan statistical area (MSA) in urban areas.

Perhaps the one most likely product market where bank concentration could be problematic is small business lending. However, informed judgments about competition in this line of business require data on shares of small business lending and actual and potential competitors in accurately identified local (less than Statewide) geographic markets. Such data are generally unavailable. Since this is the case, an admittedly second best approach may be to rely on local deposit share data to make inferences about competition in small business lending. *See* discussion under "Department of Justice Standard," below.

Statewide concentration trends are likely to provide only limited insight into the impact of banking consolidation on how banks perform, particularly with regard to setting prices and providing small business credit. The "linked oligopoly hypothesis" suggests that as large banks expand, they establish increasing numbers of contacts or links with other large rivals in different geographic markets. When the number of multimarket links become sufficiently large, the linked firms are expected to refrain from competitive initiatives in particular local markets, out of fear of retaliation in others. As a result, competition becomes less intense in the local markets in which the linked firms operate. In this hypothesis, Statewide concentration becomes problematic because it is likely to be correlated with the number of linkages between large firms.

Some researchers have suggested that as the number of linkages increases so does the intensity of competition. There have been few empirical studies of this issue. Some found weak support for the linked oligopoly hypothesis. Other, more recent, studies came to the opposite conclusion. In short, the evidence is inconclusive.

*Department of Justice Standard*

The Department of Justice has established a standard measure of concentration that it uses in bank antitrust analysis related to merger activity. That measure is the Herfindahl-Hirschmann concentration index (HHI), which it calculates based on market share of deposits. Deposits are the chosen measure of bank output for both theoretical and practical reasons.

The DOJ believes deposits at local offices accurately reflect each bank's provision of loan and deposit services to locally limited commercial and retail customers. Total bank assets cannot serve this function because significant proportions of bank assets (cash, Fed funds sold, U.S. Government securities, mortgage-backed securities, credit card portfolios, etc.) reflect involvement in markets broader than the State. In these broader markets the banks compete with many bank and nonbank competitors and are less likely to be able to exercise market power.

Some specific asset categories, like commercial loans, reflect some degree of activity in the bank's headquarters State but the amount of local lending and geographic concentrations are not known. Further, these asset proportions vary across banks and over time. Finally, unlike deposits, assets are not reported at the local office level.

The Herfindahl-Hirschmann concentration index (HHI) is calculated by summing the squares of the deposit shares of all firms in the market. For example, if a market is split equally between four firms, each with a 25 percent market share, the HHI would be 2,500 ($25^2+25^2+25^2+25^2$). The HHI reaches a maximum value of 10,000 in a monopoly, in which one firm holds a 100 percent market share ($100^2$).

The Department of Justice believes this measure is superior to three- or five-firm concentration indexes, which represent the combined shares of the biggest three or five firms, respectively. The HHI reflects the entire size distribution of firms in a market, as well as the market shares of the largest competitors. It also is an improvement because it is sensitive to disparity in market shares. Anti-competitive conduct is presumably more likely when the largest competitor in a market has a market share significantly greater than that of others. A high HHI implies fewer competitors and more uneven market shares; that disparity is not captured by the simpler three- or five-firm measures.

ESTABLISHING THE "CRITICAL" OR THRESHOLD LEVEL OF CONCENTRATION

There is a lack of consensus among economists about the "critical level" of concentration, *i.e.*, the level at which anti-competitive conduct is highly likely. The Department of Justice generally uses an HHI value of 1,800 to screen bank mergers. The DOJ presumes that mergers which result in HHI values of 1,800 or more and increase the pre-merger HHI in the affected market by at least 200 points are likely to be anti-competitive and should be denied. Significantly, the DOJ focuses on concentration changes in local, not Statewide, markets and partially considers certain nonbank competitors (S&L's) in the concentration calculations.

There is no conclusive empirical evidence that mergers which violate the DOJ concentration guidelines are highly likely to result in anti-competitive behavior. Avail-

able evidence does suggest that these thresholds are relatively conservative and it is highly likely that they will prevent excessive, merger-related increases in concentration. Throughout this analysis, we use the DOJ standard to measure concentration and to identify "critical" levels of concentration.

## Analysis of Concentration

### *Statewide Measures*

Keeping the limitations of Statewide concentration data in mind, an analysis of recent Statewide concentration levels and trends does not strongly indicate that concentration is dangerously high or rapidly increasing. Statewide HHI figures for year-end 1992, calculated using several alternative measures of bank output are included in Table 1. These figures are calculated using domestic office totals for banking organizations headquartered in each State.

The data reveal that, while the HHI calculations are somewhat sensitive to the choice of output, only roughly a third of the States showed high concentration (HHI's above 1,800). The mean and median values for each HHI measure for 1992 and 1986 are included in Table 2. The relatively small differences in 1992 means and medians relative to 1986 indicate that Statewide concentration has not increased much in many States.

### *More Local Measures*

More local concentration measures are superior indicators of the intensity of competition for locally limited small businesses but are more difficult to produce. In relatively recent testimony, Governor LaWare of the Federal Reserve Board included data on the mean three-firm concentration indexes for urban and rural markets in each year over the 1976 to 1990 period.[1] These indexes were calculated using deposit data for commercial banks.

For urban markets, the mean value of the index stood at 68.45 percent in 1976. Over the next 7 years it declined steadily, reaching 65.92 percent in 1983. After that it fluctuated in a relatively narrow range and settled at 67.35 percent in 1990. For rural markets, the mean concentration index was 90.06 percent in 1976. The rural mean followed a pattern similar to that of urban markets, reaching 89.59 percent in 1990. Thus, despite the large number of bank mergers over this long period, the data show local markets were actually less concentrated, on average, in 1990 than in 1976.

These data suggest local market concentration is relatively high. However, the data do not prove concentration in local banking markets is excessive. As noted above, there are problems in using the three-firm concentration index to indicate intensity of competition. Further, these calculations do not include S&L's and other nonbank competitors. Finally, looking only at the mean concentration levels for individual years may mask important variations in concentration across local markets over time.

## Relationship of Concentration to Holding Company Acquisition Activity

To obtain additional insight on recent levels and changes in local market concentration and also on the relationship between concentration and interstate holding company acquisitions, HHI indexes were calculated for the 29 urban markets (represented by MSA's) in four States (Indiana, Oregon, South Carolina and Washington). Those States were chosen because each has seen a substantial number of acquisitions by out-of-State bank holding companies in recent years. If acquisitions by out-of-State holding companies are associated with rapid increases in concentration, examining local market concentration trends in these States should reveal it.

HHI data for the MSA's in each State for 1988 and 1992 are provided in Table 3. The left side of the table shows HHI's calculated using only commercial bank data. The middle columns show HHI's calculated including S&L deposits with a 50 percent weight. The right hand side shows HHI's calculated including S&L deposits, weighted at 100 percent. Perhaps the most dramatic result is the significant impact of including S&L's, even at a 50 percent weight. While the difference varies across markets, including these nonbank competitors lowers the HHI in every case, by from several hundred to nearly 1,000 points.

In 1992, a review of the bank-only indexes shows that only four of the markets were below the DOJ threshold, the same number as in 1988. But when S&L competition is partially considered (deposits weighted at 50 percent), 15 of the 29 markets fall below the 1,800 HHI threshold, one fewer than in 1988. With a 100 percent

[1] The reported concentration data are drawn from Table A–6 of Governor LaWare's testimony before the Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives, September 24, 1991.

S&L weight, 19 market HHI's are under 1,800. Further, comparing 1992 to 1988 HHI's, the bank-only index declined in 17 of the 29 markets, while the index including partially-weighted S&L data declined in 16. Concentration calculated with S&L deposits weighted at 100 percent declined in 14 markets.

While this analysis certainly is far from comprehensive, these data do not indicate that local market concentration is particularly high or rapidly increasing, even in States with considerable acquisition activity by out-of-State holding companies.

CONCENTRATION AND THE RECENT DECLINE IN COMMERCIAL LENDING

*Basic Analysis*

There is a great deal of debate and uncertainty about what has caused recent declines in commercial lending by banks. No one has studied the role of market concentration in changed lending patterns. In part, this is because of the difficulties associated with accurately defining markets and obtaining relevant data. The types of commercial loans offered and the geographic market for each may differ substantially.

The market for commercial lending to small- and medium-sized businesses is primarily local, and typically much smaller than the State. No data are available to allow calculation of market shares and concentration levels for bank lending to commercial customers in sub-State geographic locations. Data also do not allow calculation of the portion of a bank's commercial loans that are made in the State in which it is headquartered.

Since the usefulness of possible calculations is uncertain, this analysis of the relationship between changes in commercial lending and concentration at the State level is somewhat limited. Using the basic measure of commercial loans, the data indicate declines in 37 States and increases in 13 States over the 1989 to 1992 time period.

The data showed no correlation between concentration and declines in lending. Twenty-nine of the 37 States showing declines, showed 1992 Statewide HHI concentration levels based on total assets that were below the DOJ threshold of 1,800.

The same result is evident if the HHI is calculated using alternative measures of output. For example, if the HHI measure is based on number of banking offices, 32 of the 37 States showing declines in lending had below threshold concentrations. When the measure is based on total deposits, the number of not-concentrated States is 31 and, for commercial loans the number of not-concentrated States is 26. Those results show no correlation between high levels of concentration and declines in commercial lending.

From the other point of view, five of the 13 States that showed increases in commercial lending were States which were concentrated (HHI based on total assets of more than 1,800).

In looking at trends in the HHI over the 1986 to 1992 period, the picture is similarly not definitive. Of the 37 States that showed declines in commercial loans, 24 showed increases in the Statewide HHI based on total assets; however, the same pattern emerged in nine of the 13 States in which lending increased. There is almost no statistical correlation between either the 1992 level of Statewide concentration or its change over the 1986 to 1992 period and the change in this measure of commercial lending.

*Broadened Analysis*

To broaden the analysis, commercial loans were defined to include loans secured by nonfarm nonresidential real estate. Using this measurement, the relationship between concentration and change in lending was even weaker.

This analysis found 27 States that showed declines in commercial loans in the 1989 to 1992 period. In 20 of these 27 States, the 1992 Statewide HHI based on total assets, was below 1,800. When the HHI is calculated based on number of offices, 23 of the 27 States show below threshold concentrations. The HHI based on commercial loans for 18 of those States show not-concentrated indexes.

To mirror the analysis performed for the basic measure, trends over time were evaluated. This broader measure of commercial lending increased in 23 States and declined in 27. In 16 of the States where loans declined, the HHI increased between 1986 and 1992. In six States where loans rose, the 1992 concentration exceeded 1,800, and in 17 Statewide concentration increased over the period. Statistical tests show basically no correlation between the change in lending and either the level of, or change in, concentration. The results are similar using HHI's for various market share measures.

Parenthetically, recent research and simple regression analysis indicate that State economic activity is substantially more important in determining the change in com-

mercial lending at the State level than either the level of, or the change in, concentration over this period.

### Value of State- and Nationwide Deposit Share Caps

There is virtually no theoretical or empirical evidence to suggest that State- or Nationwide concentration has any adverse *economic* impacts. The evidence suggests that banking markets where concentration may pose problems (most notably, small business lending) are much smaller. That evidence supports the ability of current antitrust regulation to address any potential merger-related increases in concentration.

Since there is no evidence of harm at the State and national level, uniform, largely arbitrary, limits on deposit share at that level could prove counter-productive by protecting inefficient banks from competition, constraining their opportunities to diversify, and limiting consumers' selection of prices and financial services. Deposit share caps could remove any incentive for institutions approaching the caps to price their services aggressively.

### Relation Between Declines in Commercial Lending and Dominance of Out-of-State Bank Holding Companies

If out-of-State bank holding companies (BHC's) are less interested in local business, it should be more difficult for borrowers in areas dominated by such companies to obtain credit. Similarly, recent declines in commercial lending should be more severe in such markets. This analysis focuses on State level data because data on the market shares of bank holding companies by MSA's is not readily available.

To begin, out-of-State BHC dominance must be measured. For this study, States were considered to be dominated if more than one out-of-State BHC ranked among the State's top five at year-end 1992. This classification identified 12 such States: Arizona, Colorado, Connecticut, Florida, Indiana, Kentucky, Maine, Oregon, Rhode Island, South Carolina, Texas and Washington.

Explaining the observed change in commercial loans is a complicated issue and is not exclusively the result of dominance by out-of-State BHC's. Severe regional recessions certainly exerted a strong influence on the demand for loans in several of the States identified, *i.e.*, the New England States. Other States, *e.g.*, Texas, became dominated by BHC's when failures of in-State banks caused by regional recessions resulted in sales to out-of-State BHC's. These factors raise concerns about the significance of any correlation that might be identified between dominance and change in commercial lending.

Commercial loans in the 12 dominated States declined by an average of about $1,325 million during the 1989 to 1992 period. The other 38 States showed an average decline of $1,531 million. That difference is not statistically significant. When the broader definition of commercial loans discussed above is used, the declines are $1,193 million and $487.3 million, respectively. Once again, the difference is not statistically significant. To verify the results, the test was repeated after excluding several States which had suffered sharp contractions in their economies that did not appear to be related to dominance by out-of-State BHC's (*e.g.*, Texas, Connecticut, Maine and Arizona). The results still showed no statistical difference.

*Table 1*

| STATE | HTA | HNL | HTD | HCOML | HBO |
|---|---|---|---|---|---|
| AL | 1180 | 1313 | 1093 | 1657 | 1012 |
| AK | 3022 | 2978 | 2847 | 3714 | 3192 |
| AZ | 1943 | 2056 | 2179 | 2065 | 1911 |
| AR | 313 | 339 | 314 | 450 | 375 |
| CA | 1831 | 1847 | 1784 | 1141 | 1430 |
| CO | 701 | 688 | 665 | 671 | 582 |
| CN | 2097 | 1996 | 1868 | 2890 | 1656 |
| DE | 812 | 958 | 1039 | 2668 | 2304 |
| FL | 1180 | 1304 | 1150 | 968 | 1132 |
| GA | 910 | 942 | 741 | 1738 | 681 |
| HA | 3904 | 3494 | 3401 | 3407 | 2726 |
| ID | 2512 | 2434 | 2320 | 3160 | 2051 |
| IL | 504 | 543 | 367 | 1130 | 119 |
| IN | 705 | 780 | 663 | 962 | 531 |
| IA | 254 | 327 | 214 | 494 | 219 |
| KA | 294 | 250 | 279 | 336 | 138 |
| KY | 537 | 577 | 430 | 1041 | 330 |
| LA | 585 | 588 | 553 | 796 | 379 |
| ME | 2271 | 2227 | 2125 | 2613 | 2281 |
| MD | 947 | 904 | 875 | 1401 | 847 |
| MA | 1588 | 1734 | 1495 | 2940 | 1461 |
| MI | 1275 | 1319 | 1110 | 2163 | 955 |
| MN | 1374 | 1738 | 1039 | 1950 | 542 |
| MS | 768 | 755 | 696 | 1022 | 579 |
| MO | 886 | 879 | 791 | 1137 | 485 |
| MT | 633 | 703 | 612 | 605 | 1209 |
| NE | 548 | 664 | 528 | 727 | 350 |
| NV | 2432 | 2966 | 2549 | 2749 | 2522 |
| NH | 1530 | 1453 | 1460 | 2414 | 1556 |
| NJ | 920 | 947 | 898 | 1178 | 929 |
| NM | 1018 | 954 | 982 | 1047 | 756 |
| NY | 947 | 1108 | 1005 | 998 | 761 |
| NC | 1545 | 1528 | 1211 | 2308 | 914 |
| ND | 452 | 519 | 467 | 657 | 408 |
| OH | 944 | 999 | 910 | 1249 | 819 |
| OK | 216 | 217 | 197 | 408 | 190 |
| OR | 2573 | 2890 | 2310 | 3621 | 1782 |
| PA | 884 | 800 | 726 | 1414 | 365 |
| RI | 4433 | 4563 | 3936 | 5469 | 2903 |
| SC | 1798 | 1823 | 1442 | 1625 | 1351 |
| SD | 1898 | 2168 | 262 | 2282 | 669 |
| TN | 731 | 745 | 678 | 1216 | 562 |
| TX | 645 | 908 | 541 | 1539 | 473 |
| UT | 1862 | 1885 | 1790 | 2100 | 1693 |
| VT | 1672 | 1675 | 1640 | 1782 | 1581 |
| VA | 982 | 983 | 934 | 1795 | 861 |
| WA | 1932 | 2267 | 1798 | 2151 | 1377 |
| WV | 620 | 648 | 597 | 659 | 503 |
| WI | 690 | 738 | 637 | 1006 | 557 |
| WY | 883 | 1318 | 811 | 1093 | 4173 |

HTA: State level HHI based on total assets in the domestic offices of commercial banks located in the state.
HNL: State level HHI based on total net loans in the domestic offices of commercail banks located in the state.
HTD: State level HHI based on total deposits in the domestic offices of commercial banks located in the state.
HCOML: State level HHI based on commercial loans in the domestic offices of commercial banks located in the
HBO: State level HHI based on the number of domestic offices of commercial banks located in the state.

All figures are based on year-end 1992 data.

*Table 2*

**STATEWIDE HHI MEANS AND MEDIANS**

**HTA**

| Year | 1992 | 1986 |
|---|---|---|
| Mean | 1304 | 1198 |
| Median | 947 | 948 |

**HNL**

| Year | 1992 | 1986 |
|---|---|---|
| Mean | 1369 | 1288 |
| Median | 991 | 1000 |

**HTD**

| Year | 1992 | 1986 |
|---|---|---|
| Mean | 1199 | 1062 |
| Median | 958 | 886 |

**HCOML**

| Year | 1992 | 1986 |
|---|---|---|
| Mean | 1692 | 1393 |
| Median | 1407 | 1352 |

**HBO**

| Year | 1992 | 1986 |
|---|---|---|
| Mean | 1144 | 980 |
| Median | 854 | 830 |

*Table 3*

INDIANA

| | BANKS | | BANKS+S&Ls(50%) | | BANKS+ S&Ls(100%) | |
|---|---|---|---|---|---|---|
| | 1988 | 1992 | 1988 | 1992 | 1988 | 1992 |
| MSA-8320 | 3064 | 3196 | 2565 | 2778 | 2259 | 2502 |
| MSA-7800 | 3031 | 3047 | 2382 | 2514 | 2021 | 2179 |
| MSA-5280 | 3434 | 3500 | 2398 | 2553 | 2127 | 2229 |
| MSA-3920 | 3388 | 3540 | 2700 | 2693 | 2371 | 2298 |
| MSA-3850 | 3523 | 3195 | 2390 | 2255 | 2034 | 2039 |
| MSA-3480 | 2180 | 2037 | 1795 | 1723 | 1529 | 1508 |
| MSA-2960 | 1662 | 1633 | 1085 | 1130 | 878 | 922 |
| MSA-2760 | 2652 | 2542 | 2322 | 2246 | 2081 | 2024 |
| MSA-2330 | 4406 | 3564 | 4105 | 3423 | 3858 | 3298 |
| MSA-1020 | 3443 | 3014 | 2318 | 2203 | 2083 | 1997 |
| MSA-0400 | 2688 | 2336 | 1688 | 1845 | 1456 | 1575 |

OREGON

| | BANKS | | BANKS+S&Ls(50%) | | BANKS+ S&Ls(100%) | |
|---|---|---|---|---|---|---|
| | 1988 | 1992 | 1988 | 1992 | 1988 | 1992 |
| MSA-7080 | 1829 | 2074 | 1468 | 1559 | 1443 | 1208 |
| MSA-6440 | 2666 | 3169 | 2044 | 2240 | 1958 | 1591 |
| MSA-4890 | 2236 | 2652 | 1647 | 1562 | 1383 | 1401 |
| MSA-2400 | 1833 | 2420 | 1575 | 1494 | 1461 | 1300 |

SOUTH CAROLINA

| | BANKS | | BANKS+S&Ls(50%) | | BANKS+ S&Ls(100%) | |
|---|---|---|---|---|---|---|
| | 1988 | 1992 | 1988 | 1992 | 1988 | 1992 |
| MSA-3160 | 1970 | 1515 | 1243 | 1048 | 1150 | 973 |
| MSA-2655 | 1559 | 1544 | 1096 | 1256 | 1069 | 1152 |
| MSA-1760 | 3025 | 2336 | 2113 | 1917 | 1655 | 1642 |
| MSA-1440 | 2752 | 2145 | 1357 | 1138 | 1396 | 1317 |
| MSA-0405 | 1892 | 1793 | 1215 | 1258 | 1239 | 1267 |

WASHINGTON

| | BANKS | | BANKS+S&Ls(50%) | | BANKS+S&Ls(100%) | |
|---|---|---|---|---|---|---|
| | 1988 | 1992 | 1988 | 1992 | 1988 | 1992 |
| MSA-9260 | 2412 | 1816 | 1729 | 1583 | 1501 | 1539 |
| MSA-8725 | 2618 | 2132 | 1535 | 1479 | 1296 | 1313 |
| MSA-8200 | 2194 | 2436 | 1840 | 2129 | 1658 | 1910 |
| MSA-7840 | 1785 | 1851 | 1484 | 1610 | 1302 | 1451 |
| MSA-7600 | 2728 | 2116 | 2101 | 1806 | 1689 | 1578 |
| MSA-6740 | 3432 | 3095 | 2212 | 2199 | 1741 | 1865 |
| MSA-5910 | 2709 | 1988 | 1552 | 1284 | 1270 | 1101 |
| MSA-1150 | 1814 | 2043 | 1320 | 1557 | 1204 | 1349 |
| MSA-0860 | 1784 | 1909 | 1568 | 1785 | 1432 | 1693 |

Savings & Community Bankers
of America

PAUL A. SCHOSBERG
*President & Chief Executive Officer*

October 18, 1993

The Honorable Donald Riegle
Chairman
Committee on Banking, Housing
and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

Savings & Community Bankers of America welcomes the opportunity to express our views on interstate banking and branching. SCBA is a national trade association representing more than 2,000 community-based lending institutions.

SCBA supports interstate branching for all depository institutions. Such branching has the potential to reduce risks by permitting geographic diversification and serving as a counter balance for exposure in troubled markets. Customers in these markets would benefit by having stronger, more resilient institutions with which to do business. SCBA also believes that depository institutions should be able to take advantage of potential cost savings through consolidation of operations and economies of scale inherent in interstate branching.

The Office of Thrift Supervision (OTS) has long had statutory authority to permit interstate branching by federal savings associations; 12 USC 1464(r). Under regulations promulgated by the Federal Home Loan Bank Board and subsequently adopted by the OTS, a federal association has been permitted to branch within the state in which its main office is located or outside that state in connection with the acquisition of a failing savings association; 12 CFR 556.5. On April 2, 1992, the OTS adopted a rule that allowed national branching for federal savings institutions that met or exceeded the minimum capital requirements and whose CRA record evidenced a commitment to community lending; 12 CFR 556.5. A court challenge to the rule was unsuccessful.

Interstate branching for both banks and savings institutions is sound public policy. Interstate branching permits all depository institutions to do a better job serving customer demands.

All depository institutions face significant competition from non-depository institutions, such as money market funds, insurance companies, and other providers of retail

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financial products. None of these direct competitors for banks and thrifts face geographic restrictions on their activities.

Interstate branching allows federal savings associations to geographic diversity in their asset and deposit bases. As has become all too evident in conjunction with recent regional economic downturns, an institution needs access to healthy sectors of the economy in order to remain financially viable. Interstate branching is a means to allow this geographic diversification, while meeting consumer and business needs for areas seeking investment opportunities and those needing additional credit services.

A provision of S. 810 introduced by Senator Wendell Ford, the "Interstate Banking Act of 1993," would restrict the ability of OTS to permit federally chartered savings institutions to branch interstate. This would run counter to existing policy and adversely impact successful branching operations. Failure in 1991 to enact interstate branching legislation for commercial banks should not be used to confuse the long-standing authority for branching by savings associations. While Congress considered removing the prohibitions on interstate branching by banks, it never considered restricting the branching authority existing in the Home Owners' Loan Act. To rewrite the law now would be inappropriate, reversing an existing sound and safe banking operation.

There is no evidence of consumer or customer harm by interstate branching. No one has demonstrated any draining away of deposits; indeed, the provision of additional financial services to customers is the key benefit of branching. State and federal regulations prove adequate in monitoring branching activities. No demonstrated harm has been forthcoming.

Finally, it is evident that interstate branching is but part of a broad mosaic of related financial market issues. As you have recognized in proposing legislation on regulatory consolidation, financial service providers face a range of legal and structural matter and these should be subject to comprehensive review and revision. Concerns with the health of the insurance funds, the strength of various sectors of the financial community and the disparate treatment of depository institutions including differing product restrictions, charter authorities and regulatory treatments, all come to bear even in a discussion of interstate branching.

Thank you for considering our views and opinions on this important issue.

Sincerely,

Paul A. Schosberg

cc: Sen. Alfonse D'Amato
Sen. Wendell Ford

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSER FROM EUGENE A. LUDWIG

**Q.1.** The McCarran-Ferguson Act reserves to the States the regulation of insurance unless specifically pre-empted by Congress.

Mr. Ludwig, as I understand it, your office wrote an interpretive letter to one State recently and said that no State may impose licensing or examination requirements on national banks engaged in various activities including the sale of annuities. Will this lead to regulatory inequity in that everyone who sells annuities would be subjected to all State regulations except banks?

**A.1.** The OCC's statement that you reference needs to be put into the proper context. The issue that the OCC was addressing in that interpretive letter was the conflict between Connecticut's licensing requirements and national banks' authority under Federal law to engage in certain activities. The Connecticut licensing requirements, if applicable, would have restricted national banks' authority under Federal law to sell annuities. As part of its analysis, the OCC stated that it "has [in the past] concluded that the doctrine of Federal pre-emption prohibits State authorities from imposing licensing and examination requirements on national banks engaged in various activities including the sale of annuities." After considering the issues, including the applicability of the McCarran-Ferguson Act, the OCC found that Connecticut's licensing requirements were pre-empted.

It is the OCC's position that the McCarran-Ferguson Act does not provide an independent basis for a State to impose licensing restrictions that may prohibit national banks from engaging in insurance and insurance-related activities that are permissible under Federal law. The Supreme Court has held that the Act protects a State law from Federal pre-emption only if the law is enacted for the purpose of regulating the business of insurance. Federal courts that have addressed this issue in connection with national bank insurance powers have concluded that State licensing laws that prohibit national banks from engaging in activities that are otherwise permissible under Federal law are not protected from pre-emption by McCarran-Ferguson.

In the interpretive letter which is the subject of your inquiry, the OCC found that McCarran-Ferguson did not apply and, accordingly, applied a traditional pre-emption analysis. Under that analysis, a Connecticut statute that required a license for the sale of annuities and explicitly provided that a national bank could not obtain such a license was pre-empted by the Federal authority permitting national banks to sell annuities. The letter went on to provide that a State's licensing requirements that give the State the authority to exclude national banks from the annuities business are also pre-empted by Federal law. The OCC, however, does not prohibit national banks from complying with appropriate State licensing requirements.

It does not follow that this position creates a regulatory inequity because all sellers of annuities within a State will be subject to the State's regulations except national banks. In a recent banking issuance (copy attached), the OCC directed national banks engaged in the sale of uninsured investment products, including annuities, to "comply with all applicable laws, rules, regulations, and regulatory

conditions." In taking this position, the OCC seeks to ensure that national banks sell annuities in a manner that is generally consistent with local law, particularly those laws governing consumer protection.

A final point to address your concerns about regulatory inequity is that national banks are subject to a complex regulatory scheme under Federal law. National banks are supervised by the OCC, subject to annual examination and capital requirements, and requirements that all activities be performed in a safe and sound manner. The OCC has substantial enforcement authority under Federal law to address any violations of applicable State and Federal law.

**Q.2.** Two Federal circuit courts have now ruled that national banks' authority to sell insurance, which is specifically granted by section 92 of the National Bank Act, is thereby limited by that narrow authority. What is the position of the OCC regarding the power of national banks to sell insurance outside of the two circuits?

**A.2.** The OCC believes that 12 U.S.C. § 92 is not the sole source of authority for national banks' insurance agency activities. The OCC understands 12 U.S.C. § 24(Seventh) to authorize national banks to engage in activities, including insurance and insurance-related activities, that are part of or incidental to the business of banking. Decisions in two circuits—the District of Columbia and Eighth Circuits—support the OCC's interpretation.

The District of Columbia Circuit has upheld the OCC's determination that, pursuant to § 24(Seventh), a national bank can sell municipal bond insurance through an operating subsidiary. It also has held that national banks are authorized by § 24(Seventh) to sell credit life insurance. In addition, the Eighth Circuit has criticized another Federal circuit court's opinion that § 92 is the sole authority for a national bank to sell insurance as agent, and expressed "doubts about [the] validity" of that interpretation of the law.

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# BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular    Subject: Retail Nondeposit Investment Sales

TO: Chief Executive Officers of National Banks, Deputy Comptrollers, Department and Division Heads, and Examining Personnel

## BACKGROUND

National banks are offering mutual funds, annuities and other nondeposit investments for sale to retail customers through various types of arrangements. Banks must develop programs and procedures addressing their investment sales activities to apprise customers fully of the nature of these investments. The Office of the Comptroller of the Currency (OCC) is issuing this circular to provide general guidance to national banks engaging in such activities.

Banks should view customers' interests as critical to all aspects of their sales programs. Banks that do not operate their programs safely and soundly risk potential liability from customer actions. The OCC will take appropriate actions to address unsafe and unsound banking practices and violations of law and regulations associated with bank-related sales of nondeposit investment products.

## SCOPE

The guidelines in this circular apply to bank-related retail sales (including marketing and promotional activities) of nondeposit investment products. Such sales include:

- sales made by bank employees,
- sales made by employees of affiliated or unaffiliated entities occurring on bank premises (including telephone sales from bank premises and sales initiated by mail from bank premises), and
- sales resulting from customer referrals when the bank receives a benefit for the referral.

## BANK RESPONSIBILITIES

The OCC expects national banks to comply with all applicable laws, rules, regulations, and regulatory conditions in any bank-related sale of mutual funds, annuities or other retail

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# BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular    Subject: Retail Nondeposit Investment Sales

nondeposit investment products. Bank directors are responsible for evaluating the risks posed by bank-related nondeposit investment sales. Bank directors must adopt self-regulatory policies and procedures to ensure compliance with those requirements and to ensure consistency with the guidelines in this circular. A bank's policies and procedures must address bank-related retail sales made directly by a bank, through an operating subsidiary or affiliate, or by an unaffiliated entity.

The OCC's examination authority covers all bank-related retail sales operations, including sales by other entities. Bank management should enter into a clear agreement with any entity involved in bank-related sales that outlines the duties and responsibilities of each party. The agreement should specify that such entities will comply with all applicable requirements, including those in this circular. The bank should make it clear to other entities that bank management and the OCC will be verifying such compliance. The governing agreement should include provisions regarding bank oversight and examiner access to appropriate records.

## MINIMUM STANDARDS

The antifraud provisions of the federal securities laws and regulations prohibit materially misleading or inaccurate representations in connection with offers and sales of securities. If customers are misled about the nature of nondeposit investment products, including their uninsured status, sellers could face potential liability under these antifraud provisions. Safe and sound banking also requires that bank-related sales programs be operated to avoid customer confusion about the products being offered. Use of nonbank employees to sell these products does not relieve bank management of the responsibility to take reasonable steps to ensure that the investment sales program meets these requirements.

The Rules of Fair Practice of the National Association of Securities Dealers expressly govern sales of securities by broker/dealers who are members of the NASD. These rules apply to bank-related securities sales by banking subsidiaries registered as broker/dealers, affiliated broker/dealers, and unaffiliated broker/dealers operating under agreements with banks. These rules apply whether such sales are made on bank premises or at separate locations. Even for bank-related sales where such rules do not expressly apply, the Rules of Fair Practice are an appropriate reference in constructing a compliance program for safe and sound retail sales of all nondeposit investment products.

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# BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular Subject: Retail Nondeposit Investment Sales

## GENERAL GUIDELINES

Bank-related sales of nondeposit investment products should follow the guidelines listed below. Although these guidelines are generally consistent with the requirements of the Rules of Fair Practice, they may vary to accommodate the particular circumstances surrounding bank-related sales of nondeposit investment products.

### A. Program Management

Banks should adopt a statement describing the features of the sales program, the roles of bank employees, and the roles of third party entities. At a minimum, this statement should address the following issues:

- **Supervision of personnel involved in nondeposit investment sales programs.** Senior bank managers will be expected to ensure that specific individuals employed by the bank, an affiliated broker/dealer, or a third party vender are responsible for each activity outlined in the bank's investment sales policy.

- **The roles of other entities selling on bank premises, including supervision of selling employees.** Bank management must plan to monitor compliance by other entities on an ongoing basis. The degree of bank management's involvement should be dictated by the nature and extent of nondeposit investment product sales, the effectiveness of customer protection systems, and customers' responses.

- **The types of products that the bank will sell.** For each type of product sold by bank employees, the bank should identify specific laws, regulations, regulatory conditions and any other limitations or requirements, including qualitative considerations, that will expressly govern the selection and marketing of products the bank will offer.

- **Policies governing the permissible uses of bank customer information.** Such policies should address the use of bank customer information for any purpose in connection with a bank-related retail investment sales activity.

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# BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular Subject: Retail Nondeposit Investment Sales

**B. Setting and Circumstances of Retail Nondeposit Investment Sales**

Banks should market nondeposit products in a manner that does not mislead or confuse customers as to the nature of the products or the risks. To avoid customer confusion about these products, bank policies should specifically address the locations at which sales will take place. To the extent permitted by space and personnel considerations, bank management should take steps to separate the retail deposit-taking and retail nondeposit sales functions.

Banks should prohibit tellers from offering investment advice. In addition, the OCC strongly discourages employees who accept retail deposits from selling retail nondeposit investment products. Due to the potential for customer confusion if the bank permits an employee to perform both functions, the bank should disclose this dual role to customers in addition to the disclosures outlined below.

Banks should avoid the possibility of customer confusion by following the guidelines set forth below. In addition, banks may not offer uninsured retail investment products with a product name identical to the bank's name. Banks also should recognize that the potential for customer confusion may be increased where the bank uses uninsured product names that are similar to the bank's own and should design their sales training to minimize this risk.

**C. Disclosures and Advertising**

Complete and accurate disclosure must be provided to avoid customer confusion as to whether a bank-related product is an investment product or an insured bank deposit. When selling, advertising or otherwise marketing uninsured investment products to retail customers, the following product disclosures should be made conspicuously: The products offered (1) are not FDIC insured; (2) are not obligations of the bank; (3) are not guaranteed by the bank; and (4) involve investment risks, including the possible loss of principal.

The OCC believes it is appropriate to obtain a signed statement acknowledging such disclosures from customers at the time a retail nondeposit investment account is opened. For accounts established prior to the issuance of this circular, the bank should consider obtaining such a signed statement prior to the next sale. These disclosures also should be featured conspicuously in all written or oral sales presentations, advertising and promotional

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materials, prospectuses, and periodic statements that include information on both deposit and nondeposit products.

The bank should review bank-related sales advertisements to ensure that they are accurate, do not mislead customers about the nature of the product, and include required disclosures.

Where applicable, the bank should disclose:

- The existence of an advisory or other relationship between the bank and any affiliate involved in providing the nondeposit investment product, and
- The existence of any early withdrawal penalties, surrender charge penalties, and deferred sales charges.

## D. Suitability

Consistent with the Rules of Fair Practice, the OCC expects banks to determine whether a product being recommended is an appropriate investment for the customer. Banks should ensure that any salespeople involved in bank-related sales obtain sufficient information from customers to enable the salesperson to make a judgment about the suitability of recommendations for particular customers. At a minimum, suitability inquiries should be made and responses documented consistent with the Rules of Fair Practice concerning the customer's financial status, tax status, investment objectives and other factors that may be relevant, prior to making recommendations to the customer.

## E. Qualifications and Training

Banks should ensure that sales personnel are properly qualified and adequately trained to sell all bank-related nondeposit investment products. Bank management should consider securities industry or other professional qualification training as an appropriate reference. Banks should implement training programs to ensure that sales personnel have thorough product knowledge (as opposed to simple sales training for a product) and understand customer protection requirements. Background inquiries about new bank sales employees with previous securities industry experience should include a check of possible disciplinary

history with securities regulators. Audit and compliance personnel should be properly qualified and trained as well.

F. Compensation

Bank management should ensure that compensation programs do not operate as an incentive for salespeople to sell retail nondeposit investment products over a more suitable option. If tellers participate in referral programs that include compensation features, banks should not base such compensation on the success of the sale.

G. Fiduciary Accounts

Banks must comply with all applicable state and federal restrictions on transactions involving the bank's fiduciary accounts. For example, pursuant to 12 CFR 9.12, national bank fiduciaries are restricted from using the bank's own brokerage service, or any other entity with which the bank has a conflict of interest, to conduct fiduciary transactions without express authorization in the governing trust documents, under local law, a court order, or without informed consents from all beneficiaries. Similar restrictions govern purchases of a bank's proprietary and other products for fiduciary accounts where a conflict of interest arises. If so authorized, bank trust departments are reminded that they must conduct a regular and reasonable periodic review of the continuing prudence of holding the product for a fiduciary account. Banks also should comply with any applicable provisions of the Employee Retirement Income Security Act of 1974, including its prohibited transaction provisions.

H. Compliance Program

Banks must maintain compliance programs capable of verifying compliance with the guidelines specified in this circular and with any other applicable requirements. The compliance function should be performed independently of investment product sales and management. At a minimum, the compliance function should include a system to monitor customer complaints and to review periodically customer accounts to detect and prevent abusive practices.

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# BANKING ISSUANCE

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SUPERVISION

The OCC will continue to include a review of compliance with all applicable requirements, including those in this circular, in its supervision of national banks involved in retail sales of investment products. The guidelines take effect immediately. Questions on the content of this circular may be submitted to the Office of the Chief National Bank Examiner, Capital Markets Group, Washington, DC 20219.

Susan F. Krause
Senior Deputy Comptroller for Bank Supervision Policy

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM ANDREW C. HOVE, JR.

**Q.1.** What do you think would be the principal advantages to consumers of full nationwide banking and branching? What do you believe would be the principal disadvantages?

**A.1.** Because interstate banking would promote increased competition in national and local banking markets, consumers may anticipate benefits in the form of higher deposit yields, lower loan rates and better terms, improved access to credit and generally enhanced quality in the delivery of banking services. Potentially, the most significant gains may accrue to borrowers with limited access to alternative loan sources (*e.g.*, commercial banks outside of local markets, securities markets, and various nonbank credit providers) or to customers located in local banking markets dominated by a small number of competitors.

Consumer convenience also would be enhanced by nationwide banking. Currently, banks operating across State lines are required to maintain separate subsidiaries in each State. As a result, customers in multistate areas such as DC–MD–VA are unable to fully utilize their bank's interstate facilities. For example, a customer of a Maryland-based subsidiary of a local interstate banking organization cannot make deposits at offices of the holding company's Virginia or District of Columbia subsidiaries. As an indication of the potential impact of nationwide banking and branching upon customer convenience, the 1990 Census reports that approximately 66 million people live in multistate areas (six consolidated MSA's, and 28 MSA's).

One concern often expressed by opponents of nationwide banking is that newly-arrived competitors that are less tied to local markets would channel funds to non-local loan opportunities offering the highest yields. Efficient credit markets do allocate funds in a profit-maximizing manner. However, as the recent concern about a "credit crunch" in New England demonstrates, a large number of local lenders does not guarantee easy access to credit. In the face of a shortage of attractive lending opportunities, New England's banks invested in securities or Federal funds.

**Q.2.** What protections do you believe we should put in place to protect the local, decentralized nature of our current system?

**A.2.** Many types of protections already exist to protect the local, decentralized nature of our current system. One type of protection is provided by natural market forces. If new competitors fail to satisfy legitimate local credit needs, other institutions will undoubtedly move to exploit this competitive opportunity. It is conceivable that new market entrants would inject loanable funds into these areas not only to respond to profitable opportunities, but to establish a local market presence. Second, existing community reinvestment requirements would mandate local lending. Third, various laws governing fair trade and antitrust help to ensure competitive markets. The Department of Justice's Horizontal Merger Guidelines clearly state that antitrust laws will be applied to mergers and acquisitions within the banking industry, as they are to all other industries.

**Q.3.** Presently banks can lend nationwide. Has the ability to lend nationwide assisted in diversifying the risk to the banking industry? How, if at all, would permitting banks to obtain deposits nationwide assist in diversifying the risk to the banking industry?

**A.3.** Banks' ability to lend across geographic markets, *i.e.*, across States, has undoubtedly led to greater geographic portfolio diversification among some banks than would have occurred if interstate lending were prohibited. Because data on the geographic location of banks' domestic loan customers are not available, it is difficult to know the extent of geographic diversification. It is expected, however, that larger banking institutions that are regionally- or nationally-known would attract customers from diverse locations. Smaller banks tend to have more localized customer bases, although greater diversification is possible through loan participations with other institutions.

While geographic portfolio diversification serves to reduce the risk to a bank from regional economic recessions, there are additional risks associated with out-of-market lending. Specifically, bank management would normally be less knowledgeable about customers and economic conditions outside the bank's geographic market than about those within the bank's geographic market. Therefore, banks seeking to expand loan business across State boundaries usually try to establish a presence in the targeted markets. This can be done in at least two ways. First, banks may open loan-production offices across geographic markets. These offices, however, are prohibited from engaging in typical bank branch activities, such as accepting deposits. Therefore, loans originated out-of-State would have to be funded with deposits at the bank's base of operations or through higher-cost sources of funds such as brokered deposits. Restrictions on loan-office activities also curtail many of the efficiencies associated with operating a full branch network.

A second means by which banks engage in interstate lending is by forming multibank holding companies that would be able to establish (charter) new banks across State lines. Presently, all States except Hawaii permit interstate banking through multibank holding companies. The prevalence of the multibank holding company form of organization among large banks suggests that a full bank franchise is a more profitable and efficient means of expanding geographic markets than a loan-production office.

**Q.4.** If nationwide interstate banking and branching is permitted, would you expect there to be greater consolidation among the big banks or among the smaller sized banks? Would you anticipate regional franchises to be acquired by bigger banks?

**A.4.** Removal of prohibitions against interstate banking (outside that already achieved through bank holding company operations) and interstate branching might result in some industry restructuring. It is difficult to know which group of banks, large or small, would be most affected by such restructuring. Larger banking organizations, however, have some advantages over smaller banks in terms of expanding operations through branching and/or acquisitions. Larger banks have better access to capital markets than smaller banks. There are several reasons for this advantage. Fore-

most are the fixed costs associated with issuing publicly-traded securities. These costs are primarily composed of legal, regulatory, underwriting and brokerage costs. The presence of these fixed costs makes small issues (in dollar terms) of securities not economically feasible. Because funding requirements would normally be in proportion to bank size, larger banks are able to spread these fixed costs over larger dollar capital issues. Smaller banks rely primarily upon deposits and internally generated capital (retained earnings) for funding. On the other hand, smaller banks tend to have higher capital ratios than large banks, making it potentially easier for them to expand.

In addition to greater access to outside capital, larger banking organizations may have other advantages over small banks in terms of interstate expansion. Expansion may place great demands upon the acquirer's information management systems. Larger banking organizations may be better able to absorb these costs than smaller institutions.

On balance, it is likely that larger banking organizations will have a greater tendency to expand their markets through interstate banking or branching than smaller banks. This expansion could be done either through the acquisition of existing banks or *de novo* branch expansion. The targeted banks in acquisitions may either be large or small, depending upon the markets in question. It must be acknowledged, however, that historically most bank mergers have involved large banks acquiring smaller banks, as well as mergers between large banks.

The extent of merger activity resulting from relaxation of existing restrictions on interstate banking and branching is difficult to predict. The extent of industry restructuring would depend to some extent upon whether new branching powers were a more efficient means of expanding geographic markets than multibank holding company expansion. Industry analysts frequently state that the multibank holding company is a more costly organizational form than a pure branch bank network. Yet, we believe the evidence on the cost efficiencies of multibank holding companies *versus* pure branch bank networks is mixed and inclusive. A recent study on this topic by Rhoades and Savage (1993) stated "little evidence suggests that interstate branch banks are significantly more cost-effective than multistate bank holding companies." [1]

Finally, as mentioned previously, fair trade and antitrust statutes should limit the scale and scope of mergers and thereby prevent undue concentrations of market power.

**Q.5.** If interstate banking is enacted, how should regulatory authorities guard against creating larger financial institutions that are treated as "too big to fail"?

**A.5.** In the FDIC's view, no further action is needed, because FDICIA created additional warning mechanisms and safeguards, and strengthened corrective enforcement authority. While antitrust and fair trade laws should protect against the creation of excessively large institutions that threaten competition, FDICIA pro-

[1] *See*, "Interstate Branching: A Cost-Saving Alternative?" by Stephen A. Rhoades and Donald T. Savage. *The Bankers Magazine* (July/August 1993): 34–40.

vides a system of early warning and early corrective action to help prevent systemic risk situations from occurring.

The relevant provisions of FDICIA are those requiring: (1) the application of the "least cost" test in determining the method of failure resolution; (2) a prescribed method of determining when a "systemic risk" situation exists; and (3) "prompt corrective action" (PCA) by regulators when an insured institution's capital falls below certain benchmarks. The role of these provisions with respect to the "too big to fail" issue is detailed below.

*The "Least Cost" and "Systemic Risk" Provisions*

Before FDICIA, the FDIC was required to compare the estimated cost of a payoff and liquidation against any proposed alternative resolution method. However, an alternative resolution method (such as a whole-bank acquisition, or an open-bank assistance) could be selected under either of two conditions: (1) if the alternative method was expected to be less costly than a payoff, or (2) if regardless of the cost estimation, the bank's services were determined to be "essential" to the "community." The FDIC Board of Directors determined the grounds for community essentiality. The essentiality concept was interpreted on occasion to include the consideration of systemic risk where large-bank resolutions were involved. This broadening of the essentiality concept led many to perceive that the FDIC considered some institutions "too big to fail."

"Too big to fail," however, was a misnomer. The FDIC never considered a large bank's failure *per se* as the relevant issue. Nor did the FDIC favor open-bank over closed-bank transactions for reasons other than cost. Nor did the FDIC seek to protect owners or managers of a large bank from the consequences of insolvency. Instead, the FDIC's focus was on the direct and indirect costs of imposing losses on uninsured depositors. This focus led to the FDIC's analyzing whether systemic risk considerations in large-bank cases warranted failure-resolution methods that could not be justified on the basis of cost estimation comparisons.

The passage of FDICIA drastically reduced the FDIC's flexibility regarding the application of the cost test in failure resolutions. The legislation mandates that, in the vast majority of circumstances, the FDIC choose the least-cost failure-resolution method. One implication of this least-cost requirement is that open-bank assistance may not be granted by the FDIC Board unless this option would be more cost-effective than a closed-bank resolution. Although FDICIA allows an exception to the least-cost test in the case of perceived systemic risk, the FDIC can no longer act alone. To waive the test, both the FDIC and the Federal Reserve Board must submit written recommendations supporting the waiver to the Secretary of the Treasury who, after consulting with the President, determines if the waiver should be granted. Further, in the event such a waiver is granted, the FDIC is required to recover any losses to the insurance fund through special assessments from all insured members.

FDICIA's systemic risk rule allows the flexibility to make special accommodations when circumstances are deemed to warrant them. However, the shared responsibility for determining systemic risk in cases of large-bank insolvencies, coupled with the special assess-

ment requirement, make it highly likely that the least-cost test would be applied in all but the most threatening of economic situations.

*The "Prompt Corrective Action" Provision*

The FDIC's final rule implementing PCA requirements of FDICIA went into effect on December 19, 1992. The rule restricts or prohibits certain activities and requires an insured institution to submit a capital restoration plan when it becomes "undercapitalized." There is an inverse correlation between the severity of the restrictions and prohibitions and an institution's capital level. For purposes of implementation, institutions are grouped into one of five capital categories.

The PCA mechanism brings potential problems to the attention of the regulators at earlier stages than previously. The PCA requirements have increased the probability that orderly and more-timely corrective actions and resolutions of insolvencies will take place. This reduces the likelihood that systemic risk situations will occur.

**Q.6.** In 1991, the Committee bill provided that a national bank branch should be subject to the laws of the host State as if it were a branch of a bank chartered by that State, unless such State law is pre-empted by Federal law regarding the same subject.

The 1991 Senate bill changed that provision to provide that a national bank branch shall be subject to the State laws enumerated above "as if it were a branch of a national bank having its main office in that State." Which formulation is better and why?

**A.6.** The contrasting language contained in the 1991 Committee and Senate interstate banking and branching bills could affect the types cf powers that a national bank branch which takes advantage of the bills' interstate branching rules could exercise. The FDIC has not taken a policy position on which formulation is preferable.

As an example, the two formulations would result in different insurance activity authority. The Committee bill provides that a national bank branch operating in a host State would be subject to the laws of the host State as if it were a branch of a bank chartered by the host State. This could mean that the branch could exercise certain powers (*e.g.*, selling insurance as agent from any office) available to State-chartered banks but which are not available to national banks. On the other hand, the Senate bill provides that a national bank branch operating in a host State would be subject to the laws of the host State as if it were a branch of a national bank having its main office in the host State. In this case, the branch would be able to sell insurance as agent only from offices located in towns with populations of 5,000 or less.

In other areas (*e.g.*, intrastate branching), the contrasting language would not produce different results.

**Q.7A.** In 1991 the Senate included provisions to strengthen the Community Reinvestment Act in the interstate banking and branching title of S. 543. Do you support those provisions?

**A.7A.** We support the provision of Section 301 requiring the Board to consider an applicant's record of compliance with applicable Fed-

eral and State community reinvestment laws in determining whether to approve an application. We believe, however, that current law and procedures address such applications.

We support the provisions of Section 305 regarding the written evaluation of an institution's entire record of performance under the CRA. We recognize, also, that the needs of the various communities and States vary widely and therefore that evaluation on a State-by-State basis or metropolitan area may be necessary. However, S. 543 as currently drafted appears to *require* that the regulators do a State-by-State evaluation at each examination. We believe it would be more appropriate to provide the regulators with the flexibility to do State-by-State evaluations as needed.

**Q.7B.** Do you have any additional recommendations to strengthen the Community Reinvestment Act if interstate banking and branching are permitted?

**A.7B.** We have no additional recommendations at this time. The agencies' CRA Reform Initiative, as directed by the President, is well under way and we believe we should await the outcome of that initiative prior to making any further recommendations regarding legislative change.

**Q.8.** What can we do to make sure nationwide branching is supervised effectively?

**A.8.** We believe the elements for effective supervision of nationwide branching are already in place and can be further developed as appropriate. FDICIA broadly restructured the Federal regulatory and supervisory approach to all banks, including those that might develop interstate branching networks. Particularly important are the prompt corrective action provisions of Section 131 of FDICIA, including the early closure provisions. These important reforms are proving effective in maintaining safe-and-sound conditions in the banking industry generally and in helping to ensure that individual banks that might wish to branch nationwide are sufficiently capitalized and operated in a safe manner.

Branching also is controlled specifically through the regulatory process. All branches, mergers, and acquisitions require regulatory approval. The appropriate Federal regulator with approval authority is responsible for assuring that the banks involved in any expansion proposal meet applicable statutory standards and that the branching or other form of expansion will proceed in a safe manner.

Finally, the regulators, both State and Federal, have developed extensive networks over the years for communicating and sharing information that legitimately address their respective jurisdictional needs. These information-sharing networks and other cooperative arrangements to address common supervisory concerns can be further refined and developed to address any problems or concerns prompted by nationwide branching. In short, we perceive no need for any particular or further action at this time to help ensure that nationwide branching will be effectively supervised.

**Q.9.** In 1991, the Senate-passed bill, S. 543, permitted foreign banks to branch throughout the United States from an insured subsidiary bank established in this country. In his written state-

ment, however, Governor LaWare stated that the United States should allow foreign banks to establish direct uninsured branch offices of their home country bank throughout the United States on precisely the same basis under Federal law as FDIC-insured U.S. banks to ensure that foreign banks are accorded national treatment. However, FDIC deposit insurance assessments, as well as the consumer-oriented banking laws—including CRA—that accompany FDIC insurance do not apply to uninsured U.S. branch offices of foreign banks. If the policy of national treatment is considered to require equality in interstate branching privileges in the United States for foreign banks, why should it not also require equality in these other competitively significant respects as well?

**A.9.** The passage of the International Banking Act of 1978 implemented a policy of national treatment, defined as "parity of treatment between foreign and domestic banks in like circumstances." The 1979 Treasury Department study on national treatment states that national treatment is met if foreign banks are allowed to compete on essentially equal terms with domestic institutions in the host country, even if some specific regulations or requirements applied to foreign banks differ from those affecting domestic banks. The general view is that national treatment does not require a system of regulations under which international banks must conform in every detail to the structure applicable to American banks.

In 1991, Title II of FDICIA, the Foreign Bank Supervision Enhancement Act (FBSEA), precluded foreign banks that wished to engage in retail deposit-taking activities from establishing branches in the United States. Rather, such retail deposit-taking activities must be carried out through insured subsidiary banks. These provisions contradict the structure established in the International Banking Act, designed to implement a policy of national treatment.

Foreign banks' retail deposit-taking activities in the United States are conducted through grandfathered branches in existence at the time of passage of the FBSEA or through U.S.-chartered subsidiary banks and are FDIC-insured. As such, these entities are subject to deposit insurance assessments, the Community Reinvestment Act and other consumer-oriented laws.

Uninsured foreign branches are primarily engaged in wholesale activities. They are prohibited from conducting retail deposit-taking and do not generally engage in consumer lending activities. The Community Reinvestment Act, by its terms, applies to all insured banks. The intent of the CRA is to encourage banks to meet the convenience and needs of the communities they serve. More specifically, the legislation focused on the level of reinvestment in communities from which banks obtained consumer deposits, *i.e.,* their primary savings areas. The purpose of the law was to encourage banks to serve the needs of their local communities in return for benefits such as Federal deposit insurance. Uninsured foreign branches do not enjoy the benefit of the Federal deposit insurance safety net, nor do they engage in the business of soliciting and maintaining consumer retail deposits; instead they compete for deposits in the wholesale, largely interbank market. As such, obliging them to comply with the CRA does not seem consistent with the original intent of the law, to ensure reinvestment back in the local

community from which deposits are drawn, in exchange for such benefits as deposit insurance.

**Q.10.** The U.S. offices of foreign banks conduct significant offshore "shell" branch activities not subject to U.S. laws of any type, including reserve requirements, lending limits, asset freezes, and money laundering and transactional recordkeeping requirements. Many of the balance sheets of these offshore "shell" branches are much larger than those of the U.S. offices of the foreign banks that actually operate them. Additionally, recent Federal Reserve reports indicate that the commercial lending market share held by foreign banks exceeds 45 percent when the activities conducted by their U.S. offices on behalf of their non-U.S. offshore "shell" branches are included in the activity of the U.S. offices of foreign banks. If foreign banks' U.S. offices were able to further conduct these non-U.S. "shell" branch activities throughout the United States due to liberalization of the interstate banking laws, would not foreign banks enjoy even additional significant lending and operational advantages vis-a-vis insured U.S. banks?

**A.10.** Both U.S. and foreign banks have been engaged in extensive activities at offshore "shell" branches. Such branches are attractive booking locations because, deposits are not subject to reserve requirements in some instances, or deposit insurance premiums, and the offshore branch can offer higher rates of interest on deposits. The same general incentives for booking deposit activities at their offshore banking centers exist for both U.S. banks as well as foreign banks.

Foreign banks had an additional advantage over U.S. banks prior to 1990, in that loans to U.S. borrowers booked at offshore branches of foreign banks were not subject to the Federal Reserve's. Eurocurrency reserve requirements. Under Federal Reserve Regulation D, a foreign bank branch or agency had to post a noninterest-bearing 3 percent reserve when it sold a large foreign bank certificate of deposit to fund a corporate loan. In addition, once a foreign bank's U.S. branch offices had collectively run up a net obligation to the bank's branches abroad, that bank had to post a sterile 3 percent reserve against additional Eurodollars borrowed abroad to fund U.S. assets, including corporate loans booked in the United States. But a foreign branch or agency so bound by the Eurodollar reserve requirement could avoid it by booking a loan to a U.S. firm at an offshore branch. U.S.-chartered banks could not play this game. For them the Eurodollar reserve was assessed not only against net borrowings from affiliates abroad, but also against loans to U.S. nonbanks booked at their foreign branches. As a result, a U.S. bank bound by the Eurodollar reserve requirement could not avoid it by booking a loan to a U.S. resident offshore.

This competitive advantage was eliminated in 1990 when Eurocurrency reserves were reduced to zero. After the Eurodollar reserve requirement was reduced to zero, the growth of offshore loans slowed to a crawl after years of rapid growth. Loans booked at shell branches in the Cayman Islands actually fell for the first time in 1991, after growing steadily between 1983 and 1991. In addition, a fair amount of shell branch loans have been rebooked in the United States.

As of March 31, 1993, offices of foreign banks located in the U.S. had about 35 percent of the market share of the total business loans booked through all the banking offices located in the United States. This share increases to an estimated 42 percent if adjusted for business loans to U.S. borrowers booked through offshore branches of non-U.S. banks. The overall growth in the foreign banks' market share of business loans is attributable to a number of factors. Lower funding costs, including lower costs of equity, enabled many European and Japanese banks to enjoy price advantages over U.S. banks. The international service capabilities and knowledge of innovative international banking alternatives also made foreign banks more attractive lenders than domestic banks.

While extension of interstate branching to foreign banks could enable foreign banks to make further inroads into the U.S. business lending market, it is likely to be a result of the attractiveness of foreign lenders over U.S. lenders in general, as foreign banks do not enjoy a competitive advantage in their offshore activities *vis-a-vis* U.S. banks.

**Q.11A.** In 1991 the Congress, in Section 214(a)(3) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), added a new subsection (c) to the International Banking Act of 1978 which requires foreign banks to take insured deposits in subsidiary banks incorporated in this country, rather than in direct branches of foreign banks. (The provision was enacted to safeguard the bank insurance fund and the American taxpayer who backs it from losses that might be suffered by U.S. branches of foreign banks whose full operations U.S. bank regulators do not oversee or control.) Regulations promulgated by the FDIC and OCC, however, permit foreign banks to accept certain types of non-retail, uninsured deposits of less than $100,000 in their wholesale branches. See 12 CFR 28.9 and 12 CFR 346.6. Please review these regulations to determine if all of the exceptions to the general rule against foreign banks maintaining accounts of less than $100,000 in their wholesale branches are justified.

**A.11A.** We have reviewed the six exemptions and find that they are justified. The intent of the International Banking Act was to provide deposit insurance to those branches of foreign banks that wished to do a retail banking business in the United States. Retail banking was construed by the Act as the acceptance of deposits under $100,000 unless the banking agency concerned determined that, due to the size and nature of the deposits and related accounts, the branch was not engaged in retail banking.

It is the view of the FDIC that any uninsured branch that accepts deposits within the six exemptions listed in Part 346.6 is not conducting a domestic retail deposit activity. The limited scope of the exemptions justifies this view. The first three exemptions are for profit-making entities, Government units or international organizations that are clearly not sources of retail deposits. The other three exemptions allow for the transfer of funds, regardless of size, accepting initial deposits under $100,000 from nonresidents who must also be non-United States citizens, and some accommodation of the private banking needs of business-related clients. As to the latter, the FDIC imposed a *de minimus* rule to ensure that such

private banking activities remained incidental to the branch's operations.

**Q.11B.** Do these exemptions allow foreign banks to benefit competitively? If so, in what manner? If not, why not?

**A.11B.** The advantage to the foreign bank operating an uninsured branch is the savings in deposit insurance premiums. This savings is a pure advantage as long as the bank is able to attract deposits based on its own credit standing or the standing of its home country. For lesser banks without deposit insurance, however, funding became a problem for some in the mid-1980's. For some branches, the market perceived that neither the parent nor the home country's hard resources were adequate to safely ensure repayment of dollar deposits.

**Q.11C.** To what extent do foreign banks benefit from not paying deposit insurance premiums on the deposits they take in the U.S.?

**A.11C.** The exemptions found in Part 346.6 have had positive and negative impacts on foreign banks. The positive benefit for many banks is that they can conduct wholesale banking activities through their U.S.-based branches without obtaining and paying for deposit insurance. However, American banks can now collect deposits offshore and lend in the United States, thereby equalizing this advantage of the uninsured branch.

For other foreign banks, the exceptions allow them to operate a branch in the United States that might not otherwise have been permitted, if the parent and the United States branches had to meet FDIC standards. In the early to mid-1980's, the FDIC was approached by some foreign banks, from countries experiencing cross-currency payment difficulties, interested in obtaining FDIC insurance for U.S. branch deposits. They lost interest when they learned of the scope of the FDIC's review of the parent organization, in particular, the amount of confidential data they also would have to disclose, coupled with the fact that any FDIC refusal to grant insurance would become public information.

**Q.12.** Do you see any correlation between concentration and credit availability? For example, California, Connecticut, and Nevada are heavily concentrated banking States where credit availability seems to be a problem. Is there any correlation?

**A.12.** One of the more controversial issues surrounding interstate branching concerns the impact it may have on credit availability. Some have argued that large interstate banking organizations will be less sensitive toward small businesses and will direct funds away from local community needs. Available data indicate that while smaller institutions lend a greater proportion of their assets to smaller businesses than larger institutions, there is little evidence that higher levels of concentration of banking assets result in reduced availability of credit.

Large and small commercial banks, on average, hold roughly equivalent proportions of loans in their asset portfolios. As of June 30, 1993, the 373 insured commercial banks with assets greater than $1 billion had an average loan-to-asset ratio of 57 percent, while the average for the 10,825 commercial banks with assets of less than $1 billion was 54.9 percent. The newly available data on

loans to small business show that smaller banks provide a disproportionately large share of the loans made to such borrowers, and small business loans constitute a greater proportion of their total lending, but these tendencies do not appear to be enhanced at the State level by a higher degree of concentration of banking assets. Large banks may choose different lending strategies, so that banking sectors in two States that exhibit similar concentration levels will have significantly different records with respect to large banks lending to small businesses.

The three States cited as examples of heavy concentration of banking assets—California, Connecticut, and Nevada—have other circumstances that help explain the apparent tightness of credit. All three States have experienced economic difficulties in recent years. The levels of troubled loans at banks in all three States (and particularly levels of troubled commercial loans) are well-above the national averages. In the cases of Nevada and Connecticut, loan availability appears to have become a problem only recently. From 1985 to 1989, loans held by Connecticut banks more than doubled, while loans at Nevada banks tripled. Nevada's commercial banking sector is a special situation, owing to the presence of large bank credit-card operations there; they have the effect of both increasing the apparent level of banking concentration and boosting the apparent growth of bank lending.

The banking sectors in Nevada and Connecticut are different also in that large shares of their banking assets are controlled by larger out-of-State organizations. Larger banking organization, however, have a stake in lending to small businesses. For example, some super-regional institutions have strategically targeted consumer loans and loans to small- and mid-size businesses. Other larger banks also may engage in small business lending as a way to meet their responsibilities under the Community Reinvestment Act. Any credit availability problems that would arise addressed in this fashion.

One question is whether the geographic expansion of large multistate banking organizations would lead to the demise of community banks and thus reduce a source of small business loans for small businesses. Available data indicate the answer is no. California, for example, has had unrestricted Statewide branching since 1927, and the State has had a regional interstate banking law since 1987. Nevertheless, as of June 30, 1993, California had 423 banking institutions with assets less than $1 billion, including 336 banks with assets less than $200 million.

Beyond the structural issues discussed above, a host of other factors impact the availability of credit. In our view, the volume and pace of lending to businesses and consumers depend primarily on market conditions, the demand for credit by creditworthy borrowers and the investment opportunities and alternatives available to financial institutions. Overall, it appears that smaller, community banks have been able to find a profitable niche in meeting community needs and that any credit availability problems can be addressed by existing regulations governing community reinvestment.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR ROTH FROM ANDREW C. HOVE, JR.

Senator Roth questioned the potential effect of S. 371 and S. 543 on two court decisions, *Marquette National Bank* v. *First of Omaha Service Corp.*, 439 U.S. 299 (1978), and *Greenwood Trust Co.* v. *Massachusetts*, 971 F.2d. 818 (1st Cir. 1992), *cert. denied*, —— U.S. ——, 113 S.Ct. 974 (1993).

In *Marquette*, the Supreme Court held that a national bank may "export" the interest rate it charges on a credit card loan to a borrower domiciled outside the bank's home State when that rate is greater than the maximum rate permitted pursuant to the other State's usury law. *Greenwood Trust*, decided by the Court of Appeals for the First Circuit, established the same precedent for State-chartered banks, and held that the right to export interest rates includes the right to export fees such as late charges which are material to the determination of interest.

Neither S. 371 nor S. 543 would amend 12 U.S.C. § 85 or § 1831d, the respective provisions upon which *Marquette* and *Greenwood Trust* are based. However, both bills contain almost identical provisions that would subject an out-of-State branch to the laws of the host State with respect to intrastate branching, consumer protection, fair lending, and community reinvestment, as if it were a branch of a bank with its primary place of business in that State. *See* § 302(a)(5)(A) of S. 543 and §§ 3 and 4 of S. 371.

Use of the phrases "consumer protection" and, to a lesser extent, "fair lending" could be interpreted to mean that Congress intended these bills to prohibit exportation of interest rates by an out-of-State bank into a State in which it operates a branch, thereby restricting 12 U.S.C. §§ 85 and 1831d. It could be argued that Congress intended any bank choosing to operate a branch in another State to be subjected to that State's interest rate limitations, as with all other banks operating in the State. (Banks still could export interest rates into a State if they chose not to operate a branch in that state.) On the other hand, in the absence of an explicit pre-emption of §§ 85 and 1831d, one could argue that these bills would not have the effect of prohibiting exportation of interest rates. Because of their vagueness on the issue, legislative clarification would be helpful.

We recommend that § 302 of S. 543 and §§ 3 and 4 of S. 371 be revised to clarify the intent of Congress by stating explicitly whether the phrases "consumer protection" and "fair lending" are intended to limit 12 U.S.C. §§ 85 and 1831d.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM JOHN P. LaWARE

**Q.1.** What do you think would be the principal advantages to consumers of full nationwide banking and branching? What do you believe would be the principal disadvantages?

**A.1.** For consumers, the principal advantages of full interstate banking and branching would include: (1) lower prices and improved quality of financial products and services in those market areas where current law deters entry by the potential competitors of existing banks; (2) access to the services and offices of their bank over a wider geographic area; (3) availability of specialized services

that are not usually provided by smaller banks but that can be provided in small towns through the branch networks of large banks; and, (4) continuity of banking relationships when the consumer relocates to another part of the country. In addition, there are indirect benefits to consumers that would result from gains to the banking industry such as the risk reduction associated with the greater geographic diversification of bank loan portfolios.

There should be no disadvantages to consumers resulting from full interstate banking. The antitrust laws are available to prevent the growth of local banking market concentration and a decline in competition. With the decline in legal barriers to entry in banking, new competitors—both newly chartered banks and branches of banks not previously represented in the market—should be more likely to enter both those markets in which the existing firms are earning excessive profits and those markets in which customer needs are not being served by the existing banks.

**Q.2.** What protections do you believe we should put in place to protect the local, decentralized nature of our current system?

**A.2.** We do not see any specific protections as necessary to protect the local, decentralized nature of the current system. While interstate banking will permit a bank to have branches throughout the Nation, there will likely be only a very few of these nationwide banks, even in the long run. Organizations of all sizes will be competing with these few nationwide banking organizations. Some of these competing organizations will be represented in only one market, while others will have branches across a State or region.

There are still over 8,500 banking organizations, and new banks or branches can be formed as the market demands. Anecdotal evidence suggests that new independent local banks are frequently organized in those markets in which large percentages of deposits are held by major interstate banking organizations. Evidence on the survival and success of small banks, the lack of substantial economies of scale in banking, and the general inability of large banks to increase their share of deposits in local geographic markets leads us to conclude that there is no need to provide any set of institutions with special protections.

**Q.3.** Presently, banks can lend nationwide. Has the ability to lend nationwide assisted in diversifying the risk to the banking industry? How, if at all, would permitting banks to obtain deposits nationwide assist in diversifying the risk to the banking industry?

**A.3.** Banks can indeed lend nationwide, at least in a legal sense. Currently, however, there are practical barriers to extending all types of loans on a nationwide basis. While a bank can participate in a large commercial loan to a business located far from the nearest office of the bank or can buy securities backed by mortgages on homes all over the country, it is more difficult to lend to a small business located at a distance from the bank. While the large commercial loan may be monitored by the lead bank on behalf of all the participating lenders, similar monitoring arrangements do not exist for small business loans because of the nonstandardized nature of these loans and the magnitude of information, transaction, and monitoring costs relative to the size of the loan. By allowing banks to open full service offices (as opposed to the loan production

offices that are already permitted) anywhere they desire, it should be easier for banks to achieve greater loan diversification, especially in their portfolios of smaller loans.

The improved ability to collect deposits on a nationwide basis would offer banks the opportunity to reduce seasonal, cyclical, or long-term fluctuations in the flow of deposits. It may be possible to offset expected short-term deposit outflows in one market with expected inflows in other markets and avoid purchasing higher cost nondeposit funds. Longer term, while the bank with all of its operations in one market is totally dependent upon the economy of that market, the bank with branches in many markets is less impacted by the long-term economic decline of one of its markets.

**Q.4.** If nationwide interstate banking and branching are permitted, would you expect there to be greater consolidation among the big banks or among the smaller sized banks? Would you anticipate regional franchises to be acquired by bigger banks?

**A.4.** Certainly some regional franchises would be acquired by bigger banks as the system consolidated. However, there does not appear to be any general rule as to which size class of banks would be most apt to be acquired. Both some small and some large banking organizations would be absorbed as a nationwide banking system evolved. Individual institutions would make their own decisions as to whether they should expand by making a large acquisition in a new market or entering that new market on a de novo basis; similarly, some banks—both large and small—would decide to accept acquisition offers, while others would decide to remain independent.

The key point is that research evidence indicates that banks of all sizes can survive and be profitable as independent institutions. Because there are few hostile takeovers in banking, healthy organizations are not forced to sell out to large out-of-State firms. They are only acquired on terms that the owners find acceptable.

The path by which the Nation would move to interstate banking is difficult to forecast. When the States began enacting interstate bank holding company laws, most everyone anticipated that the large California and New York City banks would quickly expand to become the major nationwide banking organizations. Instead, it has been North Carolina, Ohio, Rhode Island, Minnesota, and Missouri banks that have been the leaders in the interstate banking movement.

**Q.5.** Do you think that the present definitions of banking markets for purposes of evaluating antitrust and competitive factors are satisfactory? If not, what do you think the definition of banking markets should encompass? Is the Fed reviewing any such changes in the definition of banking markets?

**A.5.** We find the present definitions of banking markets to be satisfactory, but it is important to emphasize that the staff is continually studying product and geographic market definition issues. Indeed, the definition of the relevant geographic market(s) is reviewed in connection with each bank merger or bank holding company application acted upon by the Federal Reserve System. Staff at the Reserve Banks and the Board examine the definition proposed by the applicant and compare it with definitions from pre-

vious applications or any predefined market definition. In some cases, Board or Reserve Bank economists visit the market and survey banks, households and businesses in order to be certain that the appropriate market definition is used in assessing the competitive impact of a proposed merger or acquisition.

The Board has also conducted national surveys on the use of financial services by households and small businesses; these surveys have provided evidence on geographic and product market definitions in banking. The most recent household survey was conducted in 1992, and a 1993–94 survey of small businesses is now beginning. The Board's surveys have helped to determine the extent to which businesses and households use various financial services, including bank and nonbank, local and nonlocal services.

**Q.6.** If interstate banking is enacted, how should the regulatory authorities guard against creating larger financial institutions that are treated as being "too big to fail?"

**A.6.** The on-going expansion of interstate banking by the States has already contributed to, and will surely continue to result in, an increase in the number of large banking organizations. As I noted in my testimony, events to date are reflected in the increase in the percentage of nationwide deposits held by the largest banking organizations. Enactment of nationwide branching could accelerate this trend, but it is far from clear that the acceleration would be more than marginal. Nevertheless, it must be recognized that systemic risk is most likely in cases of financial distress at large institutions, and thus any policy that would tend to create such institutions should be reviewed carefully.

In assessing the potential for increased systemic risk several points should be made. First, other things equal, interstate banking and branching should lead to less risky banks due to the potential for increased geographic diversification of risk. Second, difficulties at a large interstate multibank holding company can be as disruptive to the financial system as difficulties at the same size branch bank. Third, while the resolution of the financial problems of a large nationwide bank would be more complicated than the resolution of such problems at a small bank, even the largest institutions are not "too big to fail." No banking organization is ever too large to escape FDICIA's prompt corrective action standards, to avoid the firing of senior management, or to prevent the loss of the stockholders' equity. For example, any bank can be required to rebuild its capital to adequate levels and, if it does not, be required to contract its assets, divest affiliates, cut its dividends, change its management, sell or close offices, and the resultant smaller entity can be merged or sold to another, better capitalized institution. If an immediate sale is not possible, the entity can be placed in receivership until a satisfactory buyer is found.

Indeed, the emphasis on capital adequacy in FDICIA, which was strongly supported by the Board, is a major element in the set of policies that protects against systemic risk. A number of other provisions of FDICIA, such as restrictions on discount window lending to financially impaired firms and the limited nature of the systemic risk exception to FDICIA's requirement for least cost failure resolution, and other regulatory policies constrain further the ability of

regulators to engage in a policy of too big to fail. For these and other reasons, the Board believes that the current regulatory system contains sufficient safeguards against a policy of too big to fail.

**Q.7.** In 1991, the Committee bill provided that a national bank branch should be subject to the laws of the host State as if it were a branch of a bank chartered by that State, unless such State law is pre-empted by Federal law regarding the same subject.

The 1991 Senate bill changed that provision to provide that a national bank branch shall be subject to the State laws enumerated above "as if it were a branch of a national bank having its main office in that State." Which formulation is better and why?

**A.7.** Both formulations attempt to address the question of the proper competitive playing field for branches of national banks located in another State. The first formulation proposes to treat national bank branches as if they were State banks in the State in which the branch is located, except in those areas that have been specifically pre-empted by Federal law. The second formulation treats out-of-State branches of national banks as if they were national banks chartered in the State in which the branches are located. We prefer the second formulation because we believe it establishes the most equitable treatment of national bank branches. The second approach also establishes the most straightforward and workable regulatory standard.

The first formulation starts with the premise that out-of-State branches of national banks should be treated for all purposes as if they were State banks. State law would be overridden only by a Federal law on the same subject. This approach established an immediate conflict between State and Federal laws governing national banks and would require the OCC and the courts to determine whether each law applicable to State banks has been pre-empted by a Federal law on the same subject.

It also appears to alter, for out-of-State branches of national banks, the pre-emption standard that would ordinarily apply to national banks. The current pre-emption standard does not require that a Federal law exist "on the same subject." Instead, State law is pre-empted if it conflicts with Federal law, frustrates the purpose of Federal law, or impairs the ability of the Federal Government to discharge its duties. Consequently, under the pre-emption standard established in the first formulation, out-of-State branches of national banks may be treated differently than national banks headquartered in the same State.

Moreover, because a national bank cannot do anything that is beyond the authority granted in its charter, the first formulation could have the effect of subjecting out-of-State branches of national banks to the strictest of Federal law and applicable State law in any area that is not pre-empted by Federal law. This would put out-of-State branches of national banks at a disadvantage in competing against State banks headquartered in the same State as the branch in areas where the national bank charter is more limiting than State law.

The second formulation starts with the premise that national banks and national bank branches located in the same State should be treated the same. This approach preserves the dual

banking system, and has the desirable effect of creating competitive equity between national banks and national bank branches located in the same State. This approach also would preserve the same competitive field between State banks and national banks, without treating out-of-State branches of national banks as a third group.

**Q.8A.** In your statement, you favor legislation permitting nationwide branching now instead of the Senate's more cautious approach of allowing the States to opt-in because the Senate bill "could put independent banks at a competitive disadvantage in branching against banks in holding companies." Would you explain this disadvantage?

**A.8A.** S. 543 takes an important step forward toward achieving full interstate banking and interstate branching by removing, after one year, the limitations currently contained in the Douglas Amendment to the Bank Holding Company Act on the ability of bank holding companies to make interstate acquisitions. The bill also permits bank holding companies to combine one or more subsidiary banks into a single bank with branches in multiple States. Together, these provisions have the effect of permitting banks in a holding company to expand across State lines by acquisition followed by a combination of banks into a single bank with branch offices without additional action by any State. Under S. 543, States may opt-out of the provision that allows interstate combinations of holding company banks.

Independent banks, by contrast, may only expand across State lines where the relevant States have chosen to authorize interstate branching under the interstate branching provisions of S. 543. The bill does not appear to grant independent banks the same authority that is granted to bank holding companies to branch across State lines through consolidation with other banks without additional action by the relevant States. This puts independent banks at a disadvantage in interstate branching against holding company banks.

The competitive disadvantage can be illustrated by two examples; the examples assume that interstate bank holding companies are allowed, while interstate branch banking is prohibited until some time in the future. First, a bank holding company headquartered in the District of Columbia could acquire subsidiary banks in Maryland and Virginia. An independent bank in the District could not establish branches in the surrounding suburbs, however, because interstate bank branching is not permitted. Thus, the independent bank is at a competitive disadvantage relative to the bank holding company unless it incurs the various costs of forming and operating a holding company. Second, if legislation only allowed the conversion of existing interstate holding company subsidiaries to branches, the independent bank in the District of Columbia, not having subsidiaries in Maryland and Virginia; would again be unable to follow its customers to the suburbs. Interstate branching would be achieved, but with the exclusion of the independent bank that had not already become a multistate, multibank holding company but would like to operate some suburban offices.

**Q.8B.** Why isn't your concern addressed by the provision in the Senate bill that allows a State to "opt-out" of conversions of interstate holding companies to branches?

**A.8B.** The "opt-out" provisions of the Senate bill are not related to this particular problem and would not overcome the advantage that existing interstate bank holding companies would have over banks that wanted to establish interstate branches without forming a bank holding company.

**Q.9.** What can we do to make sure nationwide branching is supervised effectively?

**A.9.** Although interstate branching is now generally prohibited, interstate banking on limited terms has been occurring for some time. Thus, the Federal Reserve and the other banking agencies have already developed significant expertise in the supervision of nationwide banking operations. Moreover, the banking agencies have significant experience in the supervision of large intrastate branch networks in New York and California which could also prove beneficial in supervising interstate branches. In general, the agencies have found that the supervisory procedures used in monitoring and examining intrastate organizations are also well-suited to the supervision of interstate banking organizations.

Although interstate operations provide some logistical challenges to the supervisory process, the agencies have been able to ensure that interstate activities are effectively monitored by coordinating supervisory activities among themselves and with relevant State banking authorities. Such coordination would have to continue if interstate branching legislation were enacted. However, it should be noted that the supervision of a financial organization operating branches in several States may be somewhat easier than the supervision of a group of banks owned by a common holding company and operating in these same States under different banking charters. For example, interstate banking through multibank holding company structures may require a banking organization to maintain separate bank-level policies for functions common to each of its subsidiary banks. This results in the expansion, and in many cases duplication, of examination efforts by requiring examiners to review separate policies and individually evaluate their effectiveness. If the same organization were operated as an interstate branch network, the duplication of policies would not likely be necessary.

**Q.10.** The U.S. offices of foreign banks conduct significant offshore "shell" branch activities not subject to U.S. laws of any type, including reserve requirements, lending limits, asset freezes, and money laundering and transactional recordkeeping requirements. Many of the balance sheets of these offshore "shell" branches are much larger than those of the U.S. offices of the foreign banks that actually operate them. Additionally, recent Federal Reserve reports indicate that the commercial lending market share held by foreign banks exceeds 45 percent when the activities conducted by their U.S. offices on behalf of their non-U.S. offshore "shell" branches is included in the activity of the U.S. offices of foreign banks. If foreign banks' U.S. offices were able to further conduct these non-U.S. "shell" branch activities throughout the United States due to liberalization of the interstate banking laws, would not foreign banks

enjoy even additional significant lending and operational advantages vis-a-vis insured U.S. banks?

**A.10.** The question assumes that foreign banks enjoy significant advantages vis-a-vis U.S. banks in the conduct of their respective offshore "shell" branch activities. This is not the case. For example, with regard to the two types of requirements that one might expect to have potentially the most significant effect on the competitive position of banks, namely, reserve requirements and deposit insurance premia, both U.S. banks and foreign banks currently are on an equal footing. Activities conducted out of offshore "shell" branches are subject to neither of these requirements. We would not expect liberalization of interstate banking laws to give rise to any competitive advantages with regard to such activities.

**Q.11.** Do you see any correlation between concentration and credit availability? For example, California, Connecticut, and Nevada are heavily concentrated banking States where credit availability seems to be a problem. Is there any correlation?

**A.11.** There does not appear to be a simple correlation suggesting that, in general, banks in States with greater concentration of banking resources provide fewer loans to their customers. Using 1993 data, we measured Statewide bank credit availability with four different bank lending ratios: the ratio of commercial and industrial (C&I) loans to total deposits, the ratio of C&I loans to total assets, the ratio of C&I loans plus commercial real estate leans to total assets, and the ratio of all loans to total assets. The extent of Statewide concentration of banking resources was measured by the proportion of State banking deposits accounted for by the largest three banking organizations in the State and, alternatively, by the largest five banking organizations in the State. In no case did we find a correlation between loan availability (as measured) and Statewide concentration (as measured) that would suggest less loan availability in States with higher levels of concentration. Indeed the correlations observed were, for the most part, in the opposite direction to that suggested by your question.

It is true that California, Connecticut, and Nevada all have higher than average levels of Statewide banking concentration, but only Nevada exhibits significantly lower lending ratios in the case of all four measures. California exhibits less than average ratios of C&I lending to deposits and C&I lending to assets, but not in the case of the loan ratios that include other types of business and consumer lending. Connecticut shows somewhat greater than average lending as measured by three of the four ratios. Also, some States, such as Arkansas and Iowa, have very low levels of Statewide concentration but nonetheless exhibit less than average lending, as measured by all four ratios. These are presumably the reasons why an overall negative correlation between Statewide concentration and bank lending is not observed.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR MURRAY FROM JOHN P. LaWARE

**Q.1.** In the legislation passed by the Senate in 1991, foreign banks were given the right to branch throughout the United States if they first established an insured subsidiary bank and branched from it.

On pages 10 and 11 of your testimony you contend, however, that the United States should allow foreign banks to establish direct uninsured branch offices through the United States on precisely the same basis under Federal law as FDIC-insured U.S. banks in order to ensure foreign banks get national treatment. FDIC deposit insurance and assessments, and all of the consumer oriented banking laws and regulations—including CRA—that accompany FDIC insurance, is now a much more significant responsibility that all U.S. banks have but that U.S. branch offices of foreign banks do not. If national treatment is considered to require equality in interstate branching privileges in the United States, why should it not also require equality in these other competitively significant respects as well?

**A.1.** The Board supports permitting foreign banks to establish and operate interstate branches on a national treatment basis. This would include allowing foreign banks to establish branches in the same locations as national and State banks with the same home State as the foreign bank and subject to the same terms and conditions where appropriate.

Foreign bank branches are subject to virtually all of the consumer protection statutes of U.S. banking law. These statutes are the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Truth in Lending Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Electronic Fund Transfer Act, the Federal Trade Commission Act, and the Expedited Funds Availability Act. Branches and agencies of foreign banks must comply with these statutes and are examined by the appropriate Federal banking agency for compliance.

With respect to the Community Reinvestment Act (CRA), that Act applies only to institutions that maintain deposits insured by the FDIC. Most foreign banks do not operate insured branches in the United States. If a foreign bank's branch is federally insured, it is subject to the requirements of the CRA and the FDIC monitors such branches for compliance. Since 1991, foreign banks have been unable to obtain FDIC insurance for their branches that were not already insured. In the Foreign Bank Supervision Enhancement Act of 1991, the Congress specifically prohibited foreign bank branches established after 1991 from obtaining Federal deposit insurance. Consequently, the CRA does not apply to such uninsured offices of foreign banks. As noted above, all branches of foreign banks remain subject to the other consumer protection laws.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR ROTH FROM JOHN P. LaWARE

The Supreme Court's decision in *Marquette* v. *First of Omaha* interpreted a provision of Federal law that makes national banks subject to the usury limitations imposed by the State in which the national bank is "located." (12 USC § 85) The Court found that the national bank in that case was located in the State named in the bank's organization certificate (which also was the State in which the bank was headquartered and maintained all of its branches), and rejected the proposition that a national bank is located everywhere that it has a loan outstanding. Thus, the Court found that the usury ceiling of the national bank's home State applied to all

loans made by the national bank—including loans made to borrowers in other States. In a similar case involving late charges on delinquent accounts, *Greenwood Trust Co.* v. *Mass.*, 971 F.2d 818 (1st Cir. 1992), the Court of Appeals found that an insured State bank could also apply the interest rate laws of its home State to loans made to borrowers in other States.

S. 543, as currently drafted, would not appear to affect the way in which *Marquette* and 12 USC § 85 apply to national banks that are headquartered and maintain all of their branches within the same State. Loans made by these national banks would appear to be subject only to the usury laws of the State in which the bank is located, even if the borrower resides in another State. Similarly, it would appear that, under S. 543, a typical nationally chartered credit card bank (which has no branches) would continue to be able to offer credit cards on a nationwide basis subject to the usury ceiling only of the State in which the bank is actually located.

S. 543 and S. 371 do not contain provisions that specifically deal with the application of State usury laws to banks with multistate branches. S. 543 and S. 371 both contain provisions that apply the consumer protection laws of a State to branches in that State of out-of-State national banks, but it is unclear whether these provisions encompass State usury laws. It is also unclear how the *Marquette* decision would be applied to a national banks with branches in multiple States. The only principle established by the *Marquette* case is that usury ceilings are determined by where the *bank* is located, not by where the borrower is located. The *Marquette* case left open the question of how to apply State usury ceilings to a national bank that may be located in multiple States.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM JAMES M. CULBERSON

**Q.1.** What do you think are the principal advantages to consumers of full nationwide banking and branching? What do you think are the principle disadvantages to consumers?

**A.1.** The ability of some financial institutions to eliminate redundant internal operations and boards of directors that are required under the present structure will lead to significant reductions in bank operating costs for these banks and thus reduced costs to bank customers. This Association does not believe that there are any principal disadvantages to consumers if nationwide branching is permitted. Prior experience with full intrastate branching in both California and New York have quickly dispelled concerns that small banks will be driven out of existence. In fact, well-managed community banks have thrived in such a competitive environment. Increased competition leads to better, not worse, customer service.

**Q.2.** Would you please address whether you think nationwide banking and branching will strengthen the banking system and if so, why? If not, why not?

**A.2.** The Association believes that permitting nationwide interstate banking and branching, subject to the preservation of certain rights to the States, will improve efficiencies and promote the geographic diversification of bank operations in ways that can help limit regional recessions. This will in some banks increase the institution's

and overall system's ability to withstand economic downturns. Specifically, permitting financial institutions to diversify their business beyond particular areas of the country allows them to withstand local and regional downturns by allowing revenue generated from healthy segments of the country to counterbalance losses from other areas. This stabilizes the institution and, ironically, permits it to continue to fund viable projects in economically depressed areas that otherwise could not be funded locally due to the economic pressures, including pressures on capital levels, faced by more localized institutions. This would ensure that such depressed areas continue to have their credit needs met and potentially stabilizes the downward economic trend in that community.

**Q.3.** Presently, banks can lend nationwide. Has the ability to lend nationwide assisted in diversifying the risks to the banking industry? How, if at all, would permitting banks to obtain deposits nationwide assist in diversifying the risk to the banking industry?

**A.3.** Clearly, the ability of some banks to lend nationwide has permitted them to diversify risk and survive regional downturns, allowing them to maintain and improve bank capital levels and, as a result, continue to fund local investment. Interstate banking and branching would give banks the ability to provide a full range of credit, deposit, and investment services to local consumers. Such broader operations diversity income-stream sources and help spread risk, leading to a more stable banking system.

**Q.4.** What has been the experience of the thrift industry with its ability to branch across State lines? Has that benefited consumers? Has it benefited small business? Has that benefited thrift franchises?

**A.4.** While thrift institutions have only engaged in such interstate operations to a limited degree to date, the Association believes that such institutions have streamlined operations and achieved certain economies of scale helpful to the institution's competitive position. Providing commercial banks with the authority to bank and branch nationwide would increase their ability to achieve similar efficiencies and would eliminate an unfair competitive advantage currently bestowed upon the thrift industry. Moreover, since thrift institutions, by virtue of their charters, must mainly focus on home mortgage lending and not small business credit, such small business entities fail to obtain some of the pricing benefits that such efficiencies provide. As a result, they are limited in their ability to competitively price credit products and thus face higher costs; this limits the small business' ability to operate in an efficient manner, restricting its ability to expand local employment, and limiting economic development.

**Q.5.** What is the evidence that permitting interstate banking will lead to greater concentration in banking markets due to consolidation? What is the evidence that permitting interstate banking will lead to lessened concentration in the banking markets due to new competition and entry into the markets?

**A.5.** As the Treasury Department in testimony before your committee has pointed out, the substantial involvement of nonbank entities in the financial marketplace has substantially increased the

number of major players in the financial markets, thereby reducing concerns over the inappropriate concentration of financial assets. On the contrary, continuing to restrict commercial banks from benefiting from the increased efficiencies of nationwide operations will continue to permit nonbank entities to obtain greater and greater concentrations of financial assets and potentially raise concerns over undue power. Permitting commercial banks to compete with such entities will decrease the consolidation in the financial markets.

**Q.6.** What needs to be done to assure that some inner city and rural communities that lack credit now are not left behind if interstate banking is permitted?

**A.6.** The Association believes that market pressures, coupled with the attractiveness of making investments in such inner cities and rural communities, will adequately assure that these communities will not suffer from the passage of interstate banking legislation. Furthermore, current CRA proposals would require CRA analysis on a market by market basis for interstate banks. We do not believe that any additional actions need to be taken by the Congress in this area.

**Q.7.** If interstate banking is permitted, what types of expenses would be saved by the industry? What would be the total magnitude of cost savings on an industry-wide basis from permitting interstate banking?

**A.7.** A number of large institutions have calculated the actual cost savings expected should they be permitted to consolidate interstate operations, primarily based on their ability to eliminate duplicative boards, internal operations, and other redundant functions; these savings appear to be substantial. The ABA has not done an industry-wide calculation of such cost savings.

**Q.8.** What are the State tax issues that would need to be addressed if interstate banking were permitted? How would you recommend addressing those issues?

**A.8.** There are several possible State tax issues. First, in 1991 several States questioned whether they could apply a franchise tax on a portion of interest on Government obligations of in-State branches of banks that are headquartered in other States. The banking industry agrees with the 1991 testimony of the Treasury Department that this should not be a problem; however, we have no objection to the inclusion of language affirming the ability of the State to tax a branch of an out of State bank. Similarly, we have no objection to the "shares tax" language in S. 810, or the language which clarifies that State tax authorities may "visit" and exam the books and records of an institution in the State to ensure compliance with local tax laws, assuming the institution has a physical location in the State.

The ABA favors a more uniform system of State tax laws applying to financial institutions, to prevent double taxation. Inevitably, these laws will also address the apportionment of financial institution income to various States. While a Federal statute could be used to achieve uniformity, we believe that the Multistate Tax Commission approach has been productive so far and should be

continued even though it requires adoption on a State-by-State basis.

Finally, legislation permitting multistate bank holding companies to turn some of their separate banks into branches will cause some States to have to revise their State tax laws affecting financial institutions. Those cases should be handled at the State level, and the ABA has testified that the MTC approach is a good model for the States to consider.

**Q.9.** If interstate banking is enacted, how should the regulatory authorities guard against creating larger financial institutions that are treated as being "too big to fail?"

**A.9.** Given the rapid growth of interstate banking under State laws, the ABA believes that the problems of the "too big to fail" doctrine exist whether or not interstate banking/branching legislation is passed, and that concerns over this doctrine are best addressed during discussions over the role of Federal deposit insurance and not as part of the interstate debate. The primary purpose in FDICIA of eliminating the ability of regulators to evoke the "too big to fail" doctrine except in situations of systemic risk was to ensure that sufficient market pressure would exist to adequately discipline institutions from operating in an unsafe and unsound fashion. The ABA believes the too big to fail doctrine should be eliminated entirely, but that this issue is unlikely to be dealt with and need not be dealt with in interstate banking and branching, again given the growing trend to interstate banking under State law.

**Q.10.** The interstate banking and branching provisions passed by the Senate in 1991 permitted interstate branching only through conversion of existing bank holding company banks or new acquisitions, that is, it did not provide for *de novo branching* unless a State authorized it. Do you favor such a provision and why?

**A.10.** The Association supports interstate banking and branching proposals so long as certain rights of the States are protected. Such a solution would appropriately balance both the Federal and State interests, while permitting financial institutions to adapt their operations to correspond with marketplace realities. As a result, the ABA believes that the Congress should defer to State law in determining whether or not to permit de novo branching. Currently, nearly every State has already addressed this question (in relation to permitting de novo interstate banking), either allowing de novo banking or requiring that such banking only occur through the acquisition of an existing entity. The Association believes that since State legislatures have already spoken on this subject, any Federal statutory change should preserve such decisions and extend them to cover interstate branching, thereby eliminating the need for the States to go back to their legislatures to act on an issue that has already been dealt with. States would subsequently retain the right to change such laws at a later date, should they deem it appropriate.

**Q.11.** In 1991 the bill passed by the Senate included concentration limits whereby a holding company could not acquire a bank in another State if it would give the acquiring bank control over 25 percent of a State's insured deposits (without a State waiver) or 10

percent of the nation's insured deposits (with no waiver). It also provided that Federal and State antitrust laws should continue to govern this area. Do you think we need to do anything further to prevent an over concentrated banking system?

**A.11.** The ABA has not discussed this issue in its policy-making committees nor done a market analysis of the issue and thus cannot provide a definitive comment in this area. In general, however, the ABA has long believed that anti-trust laws provide sufficient protection against concentration.

**Q.12.** In 1991, the Committee bill provided that a national bank branch should be subject to the laws of the host State as if it were a *branch* of a *bank chartered by that State,* unless such State law is pre-empted by Federal law regarding the same subject.

The 1991 Senate bill changed that provision to provide that a national bank branch shall be subject to the State laws enumerated above "as if it were a *branch* of a *national* bank having its main office in that State." Which formulation is better and why?

**A.12.** The implications to either wording involve very complicated issues of State regulation of national banks. The Association is still exploring these implications and cannot comment on this issue at this time.

**Q.13.** Your written statement argues that States should be able to opt-out of interstate banking and branching. Under the Senate passed bill, States could not opt-out of interstate acquisitions of banks by hiding companies, but could only impose minimum age-of-bank requirements. Am I correct in understanding that the ABA in supporting the Senate action in 1991 supports this kind of open interstate banking?

**A.13.** You are correct. The ABA supports permitting bank holding companies to acquire banks in any State, subject to State laws which require that the company acquire an existing institution of a certain age.

**Q.14.** In 1991 the Senate passed bill, S. 543, permitted foreign banks to branch throughout the United States from an insured subsidiary bank established in this country. In his written statement, however, Governor LaWare stated that the United States should allow foreign banks to establish direct uninsured branch offices of their home country bank throughout the U.S. on precisely the same basis under Federal law as FDIC-insured U.S. banks to ensure that foreign banks are accorded national treatment. However, FDIC deposit insurance assessments, as well as the consumer-oriented banking laws—including CRA—that accompany FDIC insurance do not apply to uninsured U.S. branch offices of foreign banks. If the policy of national treatment is considered to require equality in interstate branching privileges in the United States for foreign banks, why should it not also require equality in these other competitively significant respects as well?

**A.14.** The ABA is currently reviewing this issue at its policy-making committees and cannot provide comments on this issue at this time. As you know, the Kentucky Bankers Association raised similar concerns in its testimony before the Committee and a number of other State associations have raised such concerns in recent ABA

discussions. This is certainly an issue which deserves the careful consideration of the Committee.

**Q.15.** The U.S. offices of foreign banks conduct significant offshore "shell" branch activities not subject to U.S. laws of any type, including reserve requirements, lending limits, asset freezes, and money laundering and transactional recordkeeping requirements. Many of the balance sheets of these offshore "shell" branches are much larger than those of the U.S. offices of the foreign banks that actually operate them. Additionally, recent Federal Reserve reports indicate that the commercial lending market share held by foreign banks exceeds 45 percent when the activities conducted by their U.S. offices on behalf of their non-U.S. offshore "shell" branches is included in the activity of the U.S. offices of foreign banks. If foreign banks' U.S. offices were able to further conduct these non-U.S. "shell" branch activities throughout the United State's due to liberalization of the interstate banking laws, would not foreign banks enjoy even additional significant lending and operational advantages vis-a-vis insured U.S. banks?

**A.15.** The ABA has not discussed this issue at its policy-making committees and cannot provide comments on this issue.

**Q.16.** Do you see any correlation between concentration and credit availability? For example, California, Connecticut, and Nevada are heavily concentrated banking States where credit availability seems to be a problem. Is there any correlation?

**A.16.** The ABA has not conducted a detailed examination of any correlation between concentration and credit availability. However, we suspect that such credit availability problems relate more closely to local market pressures, local economies, transition problems and other regulatory impediments, and have little to do with the level of concentration of assets in such States.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM JAMES R. LAUFFER**

**Q.1.** What do you think are the principle advantages to consumers of full nationwide banking and branching? What do you think are the principle disadvantages to consumers?

**A.1.** The principal disadvantages are: (1) consolidation would cause greater concentration in an industry where over 73 percent of the assets are already controlled by only 100 entities; (2) there would be a loss of State and local control over decisions relating to deposit and lending services that would be offered as local boards are eliminated and decisions are made from out-of-State head offices; (3) a homogenization of the products offered that will cut down on personalized services to consumers; and (4) consolidation will cause a significant loss of jobs. These disadvantages outweigh any advantages.

The principal advantage is that customers would have access to a full range of banking services in more than one State *if* their bank chose to have interstate branches.

**Q.2.** Would you please address whether you think nationwide banking and branching will strengthen the banking system and if so, why? If not, why not?

**A.2.** There is already *de facto* nationwide interstate banking as most States have adopted interstate banking on either a regional or a national basis. nationwide branching will help a few large institutions save some money and it will give them access to greater deposits. However, this concentration will cause more too-big-to-fail banks, which means additional unfair competition for community banks and a greater potential for taxpayer liability.

In addition, as I cited in my written testimony, larger banks are not as safe as small banks. Studies conducted by Boyd & Graham and Arthur Wilmarth, Jr. show that large banks are more apt to get into trouble and they are less profitable than small banks.

**Q.3.** Presently, banks can lend nationwide. Has the ability to lend nationwide assisted in diversifying the risk to the banking industry? How, if at all, would permitting banks to obtain deposits nationwide assist in diversifying the risk to the banking industry?

**A.3.** History has shown that the ability to lend nationwide has not helped to diversify risks. Examples are the geographically distant energy loans that contributed to the failure of Continental Illinois National Bank and the *de facto* failure of SeaFirst National Bank. The Bank of New England, although it had large losses in New England, also had huge losses on loans in Florida.

The ability to collect deposits nationwide would not assist in diversifying risk. In non-emergency situations I am unaware of any systemic liquidity problems in the banking industry. There have not been recent situations where a liquidity problem has caused the failure of a healthy bank. Liquidity crises have happened in troubled banks where large deposit withdrawals have occurred because of fears about the imminent failure of the bank. A geographically diverse branching network would not ease such a liquidity crisis.

**Q.4.** What is the evidence that permitting interstate banking will lead to greater concentration in banking markets due to consolidation? What is the evidence that permitting interstate banking will lead to lessened concentration in banking markets due to new competition and entry into the markets?

**A.4.** The September 30, 1993, *American Banker* newspaper, which was cited in my written testimony, showed that there is significant and continuing concentration in the banking industry. To the extent that consolidation becomes easier and less expensive, concentration will continue.

At the hearing, Senator Bryan discussed the situation in Nevada where two banking companies control 80 percent of the banking assets, and both are from out-of-State. This situation would not have occurred if large, out-of-State institutions had not been allowed into Nevada, where they were able to buy smaller and distressed banks. California is another case in point. In my written testimony I cited Professor Arthur E. Wilmarth, Jr.'s article in the Iowa Law Journal which noted that in California 4 banks controlled 60 percent of the deposits in 1991.

There is no evidence that permitting interstate banking will lead to lessened concentration in banking markets due to new competition and entry into the markets. There are several thousand fewer banks than there were a few years ago, mostly due to mergers and

acquisitions. The larger banks keep increasing their national market share of banking assets. All of the evidence points to greater concentration, and therefore lessened competition.

**Q.5.** If interstate banking is enacted, how should the regulatory authorities guard against creating larger financial institutions that are treated as being "too big to fail?"

**A.5.** Because of the cross-guarantee provisions of FIRREA, banks can become too-big-to-fail today through interstate acquisition. NationsBank is an example. The only way to stop banks from becoming too-big-to-fail is to impose limits on the size to which they can grow through acquisition and merger.

**Q.6.** The interstate banking and branching provisions passed by the Senate in 1991 permitted interstate branching only through conversion of existing bank holding company banks or new acquisitions, that is it did not provide for *de novo branching* unless a State authorized it. Do you favor such a provision and why?

**A.6.** We are opposed to federally mandated de novo interstate branching. The States should have the power to determine whether to permit de novo interstate branching. State control allows each State to structure branch banking in a manner that serves its individual economic needs and the banking needs of its citizens. Federally mandated interstate branching would remove the ability of the States to oversee this important part of their economy.

Likewise, the dual banking system would suffer. States would lose the ability to regulate branching by out of State entities if de novo interstate branching is mandated at the Federal level. The dual banking system has served this country well by providing for innovative changes in the banking system to be made in an incremental manner and with a great many variations, thus allowing time to see what approach works the best.

**Q.7.** In 1991 the bill passed by the Senate included concentration limits whereby a holding company could not acquire a bank in another State if it would give the acquiring bank control over 25 percent of a State's insured deposits (without a State waiver) or 10 percent of the Nation's insured deposits (with no waiver). It also provided that Federal and State antitrust laws should continue to govern this area. Do you think we need to do anything further to prevent an over concentrating banking system?

**A.7.** The limits are too great and should be substantially reduced. In addition, in order to protect against the creation of too many too-big-to-fail banks, size limits must be placed on institutions, above which growth through acquisition or merger would be prohibited.

**Q.8.** In 1991, the Committee bill provided that a national bank branch should be subject to laws of the host State as if it were a *branch* of a *bank chartered by that State,* unless such State law is pre-empted by Federal law regarding the same subject.

The 1991 Senate bill changed that provision to provide that a national bank branch shall be subject to the State laws enumerated above "as if it were a *branch* of a *national* bank having its main office in that State." Which formulation is better and why?

**A.8.** We believe that the latter formulation is the most appropriate, as this would not change the branches' powers or the manner in which it is regulated.

**Q.9.** Your association believes that the States are doing a fine job addressing the interstate banking and branching needs of their States and you oppose Federal pre-emption. Do you believe, however, that we should eliminate the Federal prohibition against interstate branching by banks that are Federal Reserve members?

**A.9.** No.

**Q.10.** In 1991 the Senate passed bill, S. 543, permitting foreign banks to branch throughout the United States from an insured subsidiary bank established in this country. In his written statement, however, Governor LaWare stated that the United States should allow foreign banks to establish direct uninsured branch offices of their home country bank throughout the U.S. on precisely the same basis under Federal law as FDIC-insured U.S. banks to ensure that foreign banks are accorded national treatment. However, FDIC deposit insurance assessments, as well as the insurance do not apply to uninsured U.S. branch offices of foreign banks. If the policy of national treatment is considered to require equality in interstate branching privileges in the United States for foreign banks, why should it not require equality in these other competitively significant respects as well?

**A.10.** National treatment should provide for equal treatment of foreign and domestic banks. Most of the debate on this issue has been directed toward the treatment afforded U.S. banks by foreign countries, and the IBAA has testified before this Committee on this issue. Equally important is insuring that foreign banks do not have a competitive advantage over U.S. banks here. Foreign banks operating in the U.S. should be subject to the same laws, including deposit insurance assessments, as well as having the same privileges, as U.S. banks.

**Q.11.** The U.S. offices of foreign banks conduct significant offshore "shell" branch activities not subject to U.S. laws of any type, including reserve requirements, lending limits, asset freezes, and money laundering and transactional recordkeeping requirements. Many of the balance sheets of these offshore shell branches are much larger than those of the U.S. offices of the foreign banks that actually operate them. Additionally, recent Federal Reserve reports indicate that the commercial lending market share held by foreign banks exceeds 45 percent when the activities conducted by their U.S. offices on behalf of their non-U.S. offshore "shell" branches is included in the activity of the U.S. offices of foreign banks. If foreign banks' U.S. offices were able to further conduct these non-U.S. "shell" branch activities throughout the United States due to liberalization of the interstate banking laws, would not foreign banks enjoy even additional significant lending and operational advantages vis-a-vis insured U.S. banks?

**A.11.** Yes.

**Q.12.** Do you see any correlation between concentration and credit availability? For example, California, Connecticut, and Nevada are

heavily concentrated banking States where credit availability seems to be a problem. Is there any correlation?

**A.12.** There is a correlation. Concentration lessens competition, and therefore leads to homogenization of products. By lessening the array of credit products that are available, those entities that need credit that does not fit into the nice, little niches established by the home office cannot get credit. Additionally, the bigger the bank, the less interest it has in smaller agricultural and small business loans. The greater the competition, the greater the product base that will be available, because pricing generally is similar and the only way a bank can compete will be on the services offered.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM EUGENE A. LUDWIG AND FRANK N. NEWMAN

**Q.1.** As the Ranking Republican Member on the Senate Governmental Affairs Committee, I have worked closely with Vice President Gore to "reinvent" the Federal Government in a manner that reflects changes that have occurred at the corporate level across the Nation. The basic theme of this effort is decentralization. In contrast, the basic theme of interstate banking legislation is the very opposite. Do you have any thoughts on why banks should be centralizing while everyone else seems to be decentralizing?

**A.1.** The results that the banking industry would hope to achieve through interstate branching legislation are in many ways similar to reinventing government in that both would promote efficiencies and reduce costs. The proposed legislation would, among other things, permit a bank holding company with subsidiaries located in different States to convert those subsidiaries into branches of a single banking entity. These combinations would eliminate the need for multiple charters, duplicative corporate structures, and multiple boards of directors as well as consolidate the advertising and marketing of financial services. Such legislation would generate additional savings by decreasing the number of regulatory reports that banks must file.

Most United States businesses other than banks have always been able to expand nationwide. Interstate banking and branching legislation would accord banks the same benefits of geographic diversity. To a considerable extent, State laws have already moved in this direction. According to the recently issued GAO report entitled *Interstate Banking—Benefits and Risks of Removing Regulatory Restrictions* (November 1993), 49 States and the District of Columbia permit some form of interstate acquisition, either on an unrestricted or reciprocal basis. The report further notes that as of December 1992, a majority of U.S. banking assets were owned by 190 banking companies that operate banking subsidiaries in more than one State. Approximately one-third of these assets are held in States outside of the State in which the banking company is headquartered. Yet, despite these developments, the GAO also notes that community banks with assets of less than a $1 billion have been able to maintain their national market share. Interstate branching legislation is therefore, simply to further a process that has been ongoing for a number of years.

**Q.2.** There are several State taxation issues raised by interstate branching proposals, including the method of taxation of a branch network, the apportionment formula to be used and the degree of nexus required to assert taxing authority. Where do you stand on these issues? Do you believe that interstate banking and branching legislation as drafted in the Committee Print will operate in a revenue-neutral manner for each State budget under each State's tax laws now in effect? Do you believe that the Federal Government should "solve" the tax problems for the States? Or do you agree with CSBS that the States should be given "sufficient time to address the taxation of interstate branching?" What do you believe to be a sufficient time? Should Congress defer acting on the legislation for now? Or should Congress create a long window of opportunity for States to opt-out? Alternatively, should Congress enact an opt-in version of the legislation?

**A.2.** *Method of taxation of a branch network and the degree of apportionment to be used.* This should be left to the States, not dictated by the Federal Government. States clearly have the authority to tax branches or subsidiaries. If States' current tax laws would not raise as much revenue as the States would like under a new Federal interstate banking system, the States should change their laws.

*Degree of nexus required to assert taxing authority.* It does not matter whether a bank is a branch or a subsidiary from a nexus standpoint. In both cases, there is more than a sufficient nexus for State tax purposes, regardless of whether the tax is a franchise tax.

*Revenue neutrality from a State budget standpoint of interstate banking and branching legislation.* A law that permits entities to conduct business under different arrangements (i.e., branches v. subsidiaries) can be expected to have some effect on State revenues if States do not adjust their tax laws to account for the new arrangements. Tax rules are simply too complicated to assume that they will raise exactly the same revenues when applied to different arrangements. However, the new Federal legislation would not reduce the States' authority to tax. Thus, if States want to raise the same amount of (or more) revenue, they could change their tax laws. This is far preferable to Federal Government interference with State tax rules, which also could not possibly be revenue-neutral from a State budget standpoint.

*Appropriateness of Federal Government trying to solve tax problems for States.* No, we do not believe that the Federal Government should "solve" the tax problems of the States. To reiterate, (i) we do not believe States have a problem: they retain the authority to frame their own tax laws (including whatever changes they believe appropriate) under the new Federal legislation, and (ii) the area is inappropriate for Federal intervention.

*Provide sufficient time for States to consider interstate branching.* We do not think Congress should defer acting on the legislation. States do not need more time to discuss tax issues, because the Federal legislation will not bind their hands—they will retain the right to pass whatever tax law changes they believe they need. Indeed, interstate branching and banking legislation has been pending for years now, and the delay in the effective date of this bill will give the States additional time to revise their tax laws.

*Opt-in v. opt-out.* With one possible exception, this does not appear to be a tax issue. The possible exception (not actually raised by the Committee Print) is that States should not be able to unwind conversions of subsidiaries into branches. This could exacerbate the Federal tax consequences of the conversion.

**Q.3.** Under the Committee Print, may a State opt-out within one year after enactment of the legislation? May a State opt-out at any later time if, for whatever reason, it concludes that interstate branching is not in the public interest? If it may opt-out at a later time, may it compel branches within the State to convert back into banks?

**A.3.** Under the Committee Print, a State's choices are different for interstate acquisitions, interstate combinations, and interstate *de novo* branching. The Committee Print does not permit a State to opt-out of interstate acquisitions. With respect to interstate combinations, however, the Committee Print permits a State to opt-out at any time after enactment of the legislation, does not require the State to proffer any reason for its decision to opt-out, and does not authorize a State that later opts-out of interstate combinations after previously allowing them to compel branches within the State to convert back to their pre-combined form. Finally, with respect to interstate *de novo* branching, rather than an opt-out provision, the Committee Print provides that an out-of-state bank may branch into another State only if that other State opts-in.

**Q.4.** As a policy matter, how should the relative banking powers of the States be handled with respect to the powers of the parent company in the home State vis-a-vis the powers of the branch bank in the host State? Specifically, under the proposed legislation, might a branch of a bank in one State be allowed to do more than its parent bank located in the home State? If yes, is such a result desirable?

**A.4.** The powers and permissible activities of a national bank are determined by Federal law. Thus, generally, in order for a State law to define the powers of a national bank, that State law must be incorporated by reference into Federal law on national bank powers. Only a few State laws, such as those governing intrastate branching, have been incorporated into Federal banking law. Under the proposed legislation, it is possible that a national bank branch in a host State could, in those limited areas, have more banking powers than its parent bank has in the home State. However, since so few national bank powers are dependent on State law, it is doubtful that differences between the banking powers of the branch and the parent bank would be substantial. Moreover, with respect to intrastate branching, any difference would be in full accord with the policy of competitive equality which underlies the national bank branching law, the McFadden Act.

**Q.5.** With regard to bank insurance powers, when a bank in one State sells an insurance product to a customer in another State, is it not true today that both the bank and the product to be sold are generally required to be licensed by the insurance authorities in the customer's State?

**A.5.** We do not believe that the McCarran-Ferguson Act provides an independent basis for a State to impose licensing restrictions that may prohibit national banks from engaging in insurance and insurance-related activities that are permissible under Federal law. As you are aware, the Act provides States with the authority to regulate the "business of insurance." Specifically, the Act provides that:

> [N]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.

The Supreme Court has held that the Act protects a State law from Federal pre-emption only if the law is for the purpose of regulating the business of insurance. Federal courts that have addressed this issue in connection with national bank insurance powers have concluded that State licensing laws that prohibit national banks from engaging in activities otherwise permissible under Federal law are not protected from pre-emption by McCarran-Ferguson.

We, however, do not maintain that all State insurance laws relating to a national bank's insurance activities are pre-empted. Particular State insurance laws may be applicable to national banks because they do not conflict with national banking laws and, thus, each law must be analyzed on a case-by-case basis. However, we have recognized the special interest of the States in the regulation of insurance and, therefore, in appropriate circumstances, have not opposed compliance by national banks with State licensing requirements.

**Q.6.** Would you recommend to the President that he veto an interstate branching bill presented to him for signature that included legislative restrictions on the power of the Comptroller to exercise current discretion with regard to a national bank's incidental powers, such as those relating to insurance?

**A.6.** As you know, in our November 3, 1993, testimony before the Committee, we opposed including this type of restriction in national banking law. We stated that, when considering appropriate activities for commercial banks, two important questions should be asked. First, does the activity contribute to the safety and soundness of the banking system? Second, does it benefit consumers? The type of restriction that you describe does not promote either of these objectives. As a matter of fact, prohibiting banks from engaging in new otherwise permissible activities would undercut both of these goals.

In our testimony before the Committee on November 3, 1993, we testified that sales of insurance by national banks under current law, if conducted in an appropriate manner, contribute to the safety and soundness of the banking system and, on balance, benefit consumers. Rather than rolling back national bank insurance powers, we supported exploring the idea of giving national banks that are located in low-income, inner-city, neighborhoods new authority to sell insurance.

We cannot responsibly comment at this time on how we might advise the President regarding any legislation Congress might pro-

pose. The facts and circumstances of the specific legislative proposal must be analyzed before making that decision. However, we reiterate our view that inclusion of such a restriction would not be good policy.

**Q.7.** Would you recommend to the President that he veto interstate banking legislation presented to him for signature which included a roll-back of national bank insurance powers?

**A.7.** See response to Question 6.

**Q.8.** In his October 25th discussion of the Administration's banking program, Secretary Bentsen emphasized that the decision to accept or reject interstate branching should be left to each State. The Committee Print seems to provide an opportunity to each State to opt-out that is only one year in duration. Is that your understanding of the legislation and does that give each State enough time to make the real choice that Secretary Bentsen envisioned? How many States would be required to call special sessions of their legislatures to address the question of opting out? How many States must rewrite their tax laws to get ready for interstate branching? Will more States opt-out with a one-year window than would, for example, with a five-year window simply to protect their tax and enforcement interests?

**A.8.** The Committee Print does not set a deadline on a State's ability to opt-out of interstate combinations; rather, a State may opt-out of interstate combinations at any time after enactment of the legislation. Moreover, with respect to interstate *de novo* branching, the Committee Print provides that an out-of-state bank may branch into another State only if that other State opts-in. The Committee Print does not restrict a State's ability to reverse its decision to permit or to prohibit interstate combinations or *de novo* branching; a State always has a choice whether or not to allow interstate combinations and *de novo* branching within its borders.

**Q.9.** Dealing with a single regulator rather than many has been cited by proponents of interstate branching as an important advantage. To the extent that multi-state banks may find it easier to operate under a single regulator, while their State counterparts continue to operate under multiple regulators, won't multi-state banks prefer national charters to State charters? Do you believe that this will gradually diminish the vitality of the current dual banking system? If so, is this result desirable?

**A.9.** We do not believe that the prospect of dealing with a single regulator will be a critical factor in a bank's decision whether to convert to interstate branches. Under current law, if a bank holding company wants to reduce the number of regulatory agencies examining its subsidiary banks, it can convert all its State bank charters into national bank charters. Thus, the opportunity for a bank to reduce its number of regulators exists even without interstate branching. Despite their current ability to reduce the number of regulators, however, bank holding companies have maintained State bank charters. Thus, we see no reason to believe that the balance between the value of a national charter and the value of a State charter will be affected by interstate branching legislation. The dual banking system will remain intact.

**Q.10.** The acquisition and branching provisions of the legislation to be marked up appear to be purely domestic. Do these provisions discriminate against foreign banks? If so, are any treaties violated?

**A.10.** It appears that the Senate bill on interstate banking as a technical matter would not violate U.S. financial services treaties but would represent a change in longstanding U.S. policies to provide national treatment and jeopardize U.S. efforts to obtain increased access and national treatment in foreign markets for U.S. firms. The bill in effect would require foreign banks to establish U.S. subsidiaries in order to branch directly into more than one State. This would be contrary to our longstanding commitment to investor choice and to national treatment.

In particular, it would weaken our position in the following two areas. First, under NAFTA, the United States obtained a commitment that "At such time as the United States liberalizes its existing measures to permit commercial banks of another Party located in its territory to expand throughout significantly all the United States market either through subsidiaries or direct branches, the Parties shall review and assess market access in each Party . . . with a view to adopting arrangements permitting investor choice as to juridical form of establishment by commercial banks."

Therefore, we would anticipate negotiations with the other NAFTA parties at such time as we liberalize interstate banking measures. A subsidiary requirement for branching by foreign banks would undermine our position in these future talks.

Second, in the GATT we indicated our willingness to provide national treatment to countries which provide commitments to substantially full market access and national treatment for U.S. financial institutions. We will be engaged in intensive negotiations in financial services over the next 18 months to two years. A statute which denies national treatment even to those countries with open markets would be regarded as a bad faith action and could undermine our ability to continue negotiating to obtain satisfactory market opening agreements in the GATT. It could also lead to retaliation by countries that provide U.S. firms, including branches, national treatment.

**Q.11.** It has been the custom in many States to allow banks to enter their States only if they agreed to certain conditions. What will be the impact of converting such banks into branches under the Committee Print? Will the consolidated bank (out-of-State) and the branch (in-State) continue to be bound by the conditions after the charter is returned? Please explain.

**A.11.** The Douglas Amendment allows a State to impose conditions on a bank holding company that wishes to enter its borders by acquiring a bank located in that State. The Committee Print does not address whether these conditions will continue to apply after a bank holding company converts a subsidiary bank into a branch of a bank located in another State. However, to the extent that these conditions are imposed on the bank holding company and are not dependent on the existence of a separate subsidiary bank, the bank holding company presumably will continue to be bound by the conditions.

**Q.12.** The Committee Print defines the "home State" of a bank holding company very specifically. Do you support this definition? What is wrong with allowing [bank holding companies] to elect their home State? Why should there be a Federal policy to use a test that hinges on operations of the [bank holding company] in 1966, some time ago?

**A.12.** Insofar as the Committee Print does not permit a State to opt-out of nationwide acquisitions, it obviates the distinction between a bank holding company's home State and other States.

**Q.13.** With respect to the authorized coordination of examinations proposed by the Committee Print (page 14), what recourse do you suggest to a State examiner in a branch State who determines a bank to be unsound based on the activities of the bank's operations in its home State, though those activities are not illegal in the home State and although the branch conducts no activities violative of the laws of the branch State? How does one coordinate contradictory State policies?

**A.13.** The provision on coordination of examinations relates to state-chartered banks. State regulators are therefore in a better position to respond to this question. However, it should be noted that this provision gives the State bank supervisor of the host State the authority to examine the out-of-State *branch* of a bank resulting from a combination. Similarly, the State bank supervisor may take enforcement actions against the out-of-State *branch* as if it were a bank chartered by the host State. This provision does not seem to provide for actions by the host State against out-of-State *banks*. It is unclear to us exactly how a State regulator could take action against a *branch* alone, and not the bank itself.

**Q.14.** Does the provision entitled "Imposition of Shares Tax by Host States" in proposed section 3(h)(3)(D) of the Bank Holding Company Act (Committee Print, page 7) pre-empt State law by precluding other forms of apportionment currently employed in States without a bank shares tax? Does it preclude the use of the more traditional apportionment factors—receipts, payroll, and property—by omitting them in the enumeration?

**A.14.** Section 3(h)(3)(D) will pre-empt any State shares tax law that either (i) does not permit taxing shares of out-of-State banks or (ii) does permit this, but does not take income and capital or net worth into account in the allocation formula. This provision will not preclude consideration of factors in addition to income, capital and net worth, in the allocation formula for a State shares tax. This provision also will not pre-empt State tax laws that are not shares tax laws.

We are concerned, however, that this provision attempts to resolve on the Federal level a problem that can best be resolved at the State level (the impact of Federal law on State revenues) and, in doing so, rather arbitrarily singles out only one aspect of the problem—State shares taxes. What about the impact of the new shares tax rules on reciprocal arrangements between or among States? What adjustments should States make to the tax revenues from newly formed branches, etc.? Again, it is better to be silent about State tax rules.

**Q.15.** Finally, how do the provisions of the Bank Merger Act interact with the proposed provisions of section 3(h) of the Bank Holding Company Act of 1956 when an application for a consolidation is made?

**A.15.** While the Committee Print does not expressly address this, we believe that consolidations under section 3(h) are subject to approval under applicable laws such as the Bank Merger Act and provisions of the National Bank Act governing consolidations by national banks. Thus, the Bank Merger Act would apply and the appropriate Federal regulator of the acquiring institution would review the consolidation under the Bank Merger Act. This is in accordance with the procedure now followed with respect to the consolidation of banks whether or not commonly owned by a bank holding company. We do not believe that section 3(h) adds any additional approval requirements not currently present in the law nor are any additional approval requirements necessary. However, to clarify this issue we believe the consolidation provision should be codified in the Bank Merger Act not the Bank Holding Company Act.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM BARBARA WALKER

**Q.1.** The bill passed by the Senate in 1991 provided that any interstate acquisitions made possible by its provisions should continue to be subject to both State and Federal antitrust laws. It also provided, however, as an extra precaution against an over-concentrated banking system that a bank could not expand by acquisition after it garnered 10 percent of the country's banking deposits or 25 percent of a States' banking deposits. The State ceiling was waivable by the State. Does such a precaution make sense to you or is it sufficient to rely on State and Federal antitrust laws to govern such matters?

**A.1.** Federal antitrust rules are plainly inadequate to restrain the ongoing consolidation trend in the banking industry—a trend that will be intensified if Congress removes the remaining geographic restrictions on bank expansion. For example, after applying the current Federal antitrust standards, the Federal Reserve Board and the Justice Department permitted BankAmerica to acquire Security Pacific, even though that acquisition allowed BankAmerica to control more than 40 percent of the total banking assets in California and more than 30 percent of such assets in Arizona, Nevada, and Washington. Another result of this acquisition is that two-thirds of California's banking assets are now controlled by just three bank holding companies (BankAmerica, Wells Fargo, and First Interstate).

A recent simulation study by Stephen Rhoades, Chief of the Financial Structure Section at the Federal Reserve Board, concluded that the Justice Department's current merger guidelines would: (i) permit all of the six largest banks in New York City to combine, and (ii) allow a consolidation of our entire banking industry into as few as six to nine nationwide banks. Stephen A. Rhoades, *Consolidation of the Banking Industry and the Merger Guidelines*, 37 *Antitrust Bulletin* 689 (1992). These findings are hardly surprising in view of the fact that Federal antitrust laws have permitted highly

concentrated oligopolies in many other industries (*e.g.*, the automobile, steel, and petroleum industries).

State laws have played an important role in restraining concentration in the banking industry. Sixteen States have adopted "deposit cap" laws restricting the maximum percentage of Statewide deposits that can be owned by a single banking organization. The Supreme Court has held, in a nonbanking case, that Federal antitrust laws do *not* pre-empt the authority of the States to impose stricter antitrust rules. *California* v. *ARC America Corp.*, 490 U.S. 93 (1989).

In view of the inadequacy of current Federal antitrust rules, CSBS strongly believes that any Federal legislation permitting interstate branching must include concentration limits similar to those contained in the 1991 Senate bill, which would have prohibited acquisitions resulting in the ownership by any one bank of more than 10 percent of nationwide deposits or more than 25 percent of any State's deposits. CSBS also believes that, in view of the strong interest of each State in regulating its own banking structure, each State should be permitted *either* (i) to adopt a stricter Statewide concentration limit than that contained in Federal interstate branching legislation, *or* to waive the Federal Statewide concentration limit.

**Q.2.** On pages four and five of your testimony you raise concerns about the applicable law provisions contained in the 1991 Senate bill. With regard to national banks those provisions provide that host State authority over an incoming branch of an out-of-State national bank should be the same as it has over a branch of a national bank already headquartered in the host State. Why is that not a satisfactory formulation?

**A.2.** The 1991 Senate bill would have applied host State laws to branches of out-of-State national banks to the same extent that such laws applied to a national bank headquartered in the host State. The operations of national banks are currently subject to State laws *except* for State laws that: (i) discriminate against national banks, (ii) conflict with Federal laws that apply to national banks, or (iii) place an undue burden on the functions of national banks. *Anderson National Bank* v. *Luckett,* 321 U.S. 233, 247–48 (1944); *National State Bank* v. *Long,* 630 F.2d 981, 985–86 (3d Cir. 1980). The Office of the Comptroller of the Currency ("OCC") is responsible for making examinations and taking administrative measures to enforce applicable State laws against national banks. *Long,* 630 F.2d at 987–89.

The problem is that the OCC has frequently asserted a blanket power to pre-empt the application of State laws to national banks, based on the vaguely-defined prohibition in 12 U.S.C. 484 against the exercise by State officials of "visitorial powers" over national banks. For example, in the OCC's Interpretive Letter No. 614, dated January 15, 1993, the OCC claimed that consumer protection laws in Idaho, Wyoming, and Wisconsin were pre-empted to the extent that those State laws: (i) required national banks to file reports with State officials, and (ii) authorized State officials to bring suit in court against national banks that failed to comply with such laws.

The OCC's interpretive ruling was clearly wrong, because the Supreme Court has specifically affirmed the authority of State officials to sue in court to enforce State laws against national banks (*e.g., First National Bank in St. Louis* v. *Missouri,* 263 U.S. 640, 659–61 (1924)), and to require reports from national banks regarding their compliance with State laws (*e.g., Anderson National Bank,* 321 U.S. at 252–53). However, it is difficult and expensive for the States to engage in repeated litigation with the OCC in order to overturn the OCC's erroneous claims of pre-emptive power.

As indicated on pages 4–5 of our testimony, any Federal interstate legislation should make clear that specific types of non-discriminatory host State laws (e.g., laws governing intrastate branching, consumer protection, fair lending, competitive practices, and community reinvestment) should apply to State banks chartered by the host State. Such a provision would provide significant benefits in three areas. First, it would ensure that the specified State laws would not be pre-empted unless they discriminated against national banks or were pre-empted by another Federal statute on the same subject. Such a strong statutory statement of non-pre-emption would prevent the OCC from continuing to assert unfounded claims of regulatory pre-emption.

Second, the recommended provision would enable the States to apply the same laws to local branches of out-of-State national banks as they currently apply, under Section 7 of the Bank Holding Company Act, to out-of-State bank holding companies with local bank subsidiaries. The States have exercised their reserved powers under Section 7 in a prudent and responsible manner with respect to interstate bank acquisitions. There is no reason to believe that the States would act in a different way with regard to interstate branching.

Third, the recommended provision would establish parity between interstate branches of both national and State banks. In this way, the provision would help to ensure that Federal interstate branching legislation does not undermine the dual banking system by encouraging State banks with out-of-State branches to convert to national charters.

**Q.3.** The 1991 Senate passed bill also provided that the host State should be able to apply its laws with respect to intrastate branching, consumer protection, fair lending, and community reinvestment to incoming branches of a State chartered bank headquartered outside of the State. Is that formulation satisfactory? If not, how would you want it changed and why?

**A.3.** No, this formula is not satisfactory. This section should not provide an exclusive list of applicable State law because the problem of Federal pre-emption which was discussed in the previous question does not exist. The section should read that State bank branches should be subject to the laws of the host State as if it were a branch of a bank chartered under the laws of that State. The language which includes the list of host State law that the branch would be subject to (intrastate branching, consumer protection, fair lending, and community reinvestment) should be deleted.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR ROTH FROM BARBARA WALKER

**Q.1.** There are several State taxation issues raised by interstate branching proposals, including the method of taxation of a branch network, the apportionment formula to be used and the degree of nexus required to assert taxing authority. Where do you stand on these issues? Do you believe that interstate banking and branching legislation as drafted in the Committee Print will operate in a revenue-neutral manner for each State budget under each State's tax laws now in effect? Are the State tax commissioners "ready" for interstate branching? How many States must rewrite their tax laws to get ready for interstate branching? How many States would be required to call special sessions of their legislatures to address the question of opting out? You testified that the Federal Government should not "solve" the tax problems for the States but that the States should be given "sufficient time to address the taxation of interstate branching." What do you believe to be a sufficient time? Should Congress defer acting on the legislation for now? Or should Congress create a long window of opportunity for States to opt-out? How long? Alternatively, should Congress enact an opt-in version of the legislation?

**A.1.** CSBS has been working closely with the various State tax groups on this issue. Interstate branching will create a new system of operation that will require revisions of each State's tax code. Without the appropriate time given for this revision, many States will lose tax revenues. The Multistate Tax Commission and the Federal of Tax Administrators are drafting the necessary changes to adjust to interstate branching and we are told that implementation of these revisions will take 5–7 years. According to the Committee Print, interstate branching will be effective in one year. This is not enough time for States to enact their new tax codes. Many States only meet every two years and will be losing much needed revenue in the meantime. To allow States sufficient time to adjust to the new system of bank operations, the enacting clause for interstate branching should be extended to at least five years. CSBS supports the opt-in version of interstate branching which would allow States to enact legislation that would be appropriate to their unique position in bank regulation. This would give States adequate time to prepare for the considerable changes interstate branching would bring.

**Q.2.** Under the Committee Print, may a State opt-out within one year after enactment of the legislation? May a State opt-out at any later time if, for whatever reason, it concludes that interstate branching is not in the public interest? If it may opt-out at a later time, may it compel branches within the State to convert back into banks?

**A.2.** The Committee Print would allow a State to opt-out of interstate branching within one year after enactment. While a State may opt-out at any time after enactment of this legislation, it may not require branches to convert back into banks. These activities would apparently be grandfathered and no future expansion would be allowed. This timeframe does not give States the time necessary to consider all the elements and determine whether it wants to

allow interstate branching. Their frustration with the short time period may force an opt-out decision.

**Q.3.** As a policy matter, how should the relative banking powers of the States be handled with respect to the powers of the parent company in the home State vis-a-vis the powers of the branch bank in the host State? Specifically, under the proposed legislation, might a branch of a bank in one State be allowed to do more than its parent bank located in the home State? If yes, is such a result desirable?

**A.3.** CSBS believes that the State which charters the bank should have authority over its ability to engage in certain powers, regardless of where it operates. With the onset of interstate branching, States will have to regulate activities of its bank's branches in other States for the first time. These host States may or may not allow their banks to engage in similar or expanded bank powers. Several scenarios will arise. First, using insurance sales as an example, if the home State and the host State both allow their banks to engage in the sale of insurance, banks will continue to be able to exercise that power in either State. Second, if the home State of a branch allows insurance sales but the host State does not, the branch should not be allowed to sell insurance. If the home State did allow its banks to sell insurance in the host State, this would put banks in the host State at a competitive disadvantage against the incoming branches. This scenario may also exist in the reverse. If a branch enters a State which allows insurance sales while its home State does not, we believe that the branch should not automatically be allowed that power. States should, however, have the ability to grant their bank branches parity with the banks in the host State. The final scenario would be in which both the home and host States prohibit a certain bank activity, thus eliminating the bank's ability to conduct this activity altogether.

Under the Committee Print, a State bank will not be allowed to engage in any activity in a host State not authorized for the host State's own banks.

**Q.4.** It has been custom in many States to allow banks to enter their States only if they agreed to certain conditions. What will be the impact of converting such banks into branches under the Committee Print? Will the consolidated bank (out-of-State) and the branch (in-State) continue to be bound by the conditions after the charter is returned? Please explain.

**A.4.** Under both the interstate banking and branching provisions of this bill, States can no longer set conditions on incoming banks and branches. The Print repeals the Douglas Amendment to the Bank Holding Act which provides the nexus for States to set conditions. With interstate branching, banks will no longer be required to operate through a bank holding company to acquire and establish operations interstate. By doing away with the need for a bank holding company structure, this print would eliminate the State's ability to set conditions on the entry of out-of-State banks. Conditions that will be eliminated by the Committee Print include reporting requirements of loan, deposit, trust, and other activities which States rely on when deciding on new bank charters, branch applications and the assessments of market concentrations and

needs. Other conditions concern: location of branches including requiring branches in underserved areas such as low-income neighborhoods; State consumer laws; and, enhancing economic development.

The Committee Print should be changed to preserve the State's ability to set these and other conditions on the operations of banks within their borders to assure participation in both economic initiative and consumer protection.

The Committee Print does allow States to set conditions if it opts-in before one year after enactment. It (will be practically impossible) is highly unlikely that States will be able to consider interstate branching legislation at such a short notice and without any prior study of the issue.

**Q.5.** Does the provision entitled "Imposition of Shares Tax by Host States" in proposed section 3(h)(3)(D) of the Bank Holding Company Act (Committee Print, page 7) pre-empt State law by precluding other forms of apportionment currently employed in States without a bank shares tax? Does it preclude the use of the more traditional apportionment factors—receipts, payroll, and property—by omitting them in the enumeration?

**A.5.** It is unclear what this section would do. It seems that Congress is giving the States permission to convert their shares tax to apportionment. This is unnecessary authorization and suggests that other forms of bank tax are not approved. Without additional clarifying language, the Committee Print seems to eliminate the ability of States to use other tax formulas besides bank shares tax. Currently, only a handful of States use this form of tax. This section also suggests that traditional formulas and their factors for apportionment cannot be used. By favoring one form of tax, the Print is jeopardizing other State's ability to impose their form of bank shares tax.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM GERALD M. NOONAN

**Q.1.** The bill passed by the Senate in 1991 provided that any interstate acquisitions made possible by its provisions should continue to be subject to both State and Federal antitrust laws. It also provided, however, as an extra precaution against an over-concentrated banking system that a bank could not expand by acquisition after it garnered 10 percent of the country's banking deposits or 25 percent of a States' banking deposits. The State ceiling was waivable by the State. Does such a precaution make sense to you or is it sufficient to rely on State and Federal antitrust laws to govern such matters?

**A.1.** There has been no evidence to date that State and regulatory authorities in place now, have been unable to monitor and assess over-concentrations. While this is always an issue of concern, the CBA feels that further legislation is not needed at this time.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM REV. CHARLES R. STITH

**Q.1.** The bill passed by the Senate in 1991 provided that any interstate acquisitions made possible by its provisions should continue

to be subject to both State and Federal antitrust laws. It also provided, however, as an extra precaution against an over-concentrated banking system that a bank could not expand by acquisition after it garnered 10 percent of the country's banking deposits or 25 percent of a States' banking deposits. The State ceiling was waivable by the State. Does such a precaution make sense to you or is it sufficient to rely on State and Federal antitrust laws to govern such matters?

**A.1.** I think that the extra safeguard limiting only bank's market share to 10 percent nationally and 25 percent Statewide makes good sense, so I would support including such a provision in any new legislation on interstate banking. The danger of creating "super-regional" banks is that it becomes too difficult to hold them accountable for their community lending policies and practices across many States. So specifying a cap on market share is an important safeguard.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM BALLARD W. CASSADY, JR.

**Q.1.** The bill passed by the Senate in 1991 provided that any interstate acquisitions made possible by its provisions should continue to be subject to both State and Federal antitrust laws. It also provided, however, as an extra precaution against an over-concentrated banking system that a bank could not expand by acquisition after it garnered 10 percent of the country's banking deposits or 25 percent of a States' banking deposits. The State ceiling was waivable by the State. Does such a precaution make sense to you or is it sufficient to rely on State and Federal antitrust laws to govern such matters?

**A.1.** The "cap" concept contained in Title III of S. 543 was considered in 1991 for two reasons:

First, applicability of State and Federal antitrust laws often turn on complicated factual determinations which can only be resolved after long and expensive investigation and, in some cases, litigation. As a result, sole reliance upon such laws will often result in uncertainty as to the legality of an acquisition and corresponding detriment to the banking industry and the public it serves.

Second, "deposit caps" exist in many State laws currently regulating interstate acquisitions and were often important considerations in the political process resulting in the enactment of those laws. Consequently, they represent time-tested standards by which interstate acquisitions have been judged in the past. In short, they are familiar guides preventing undue concentration of banking facilities which, at the same time, do not unreasonably impede interstate acquisitions.

However, limiting banks to "deposit caps" only serves to restrict banks to a constant percentage share of a decreasing market. Bank's market share of total financial assets has decreased from 60 percent to a current market share of 27 percent. This establishes that there are other players in the financial arena competing for bank assets and liabilities (deposits). As a result, current thought would "cap" ownership of total financial assets or deposits not just bank deposits. This would help to assure that no financial institu-

tion—whether it be a bank, insurance company, securities firm, etc.—would control more than X percent of financial deposits or assets.

**Q.2.** The interstate banking provisions passed by the Senate in 1991 provided that foreign banks could branch interstate by first establishing an insured subsidiary bank in this country and then branching from such bank. Governor LaWare of the Fed has criticized that formulation for denying foreign banks *parity* of treatment in their interstate operations. He prefers that the wholesale branches of foreign banks also be permitted to branch interstate. Do you think his criticism is fair? If not, why not?

**A.2.** Absolutely not.

As stated in my November 2, 1993, testimony before the Committee, Governor LaWare's criticism was, in my judgment, "surprising" in that it ignores the "preferential" treatment currently enjoyed by foreign banks and their off-shore shells over United States banks. His position is, in my view, unfair and ignores the competitive advantages which foreign banks enjoy over competing U.S. banks in, among other things, pricing loans and deposits. See Answer to Q.3. below.

Congress has *always* stated that its efforts were directed to giving "national treatment" to foreign companies. By Congress' own definition that effort entails assuring that ". . . a foreign bank in a particular nation should be accorded operating privileges which provide such banks with the opportunity for *competitive equality with their host country domestic counterparts.*" (Senate Report No. 95–1073 as reprinted in *U.S. Code Congressional and Administrative News,* 1978, V.3. p. 1438).

If this was in fact what was happening in the United States, foreign banks would be required to establish U.S. subsidiaries, obtain either State or national charters, offer FDIC insurance, be involved with CRA (Community Reinvestment Act) compliance at *every* location and satisfy the same standards, regulations, capital requirements and oversight to which U.S. banks are obligated. But this is not what is happening. Between 1978 and year end 1990, assets of foreign bank branches and agencies in the United States have grown at an average annual rate of nearly 21 percent with no single year's growth being less than 8 percent. Between 1990 and year end 1992, foreign bank's annual growth averaged 6.5 percent; however, during this same period growth of domestic offices of U.S. banks increased less than 1 percent.

If it is assumed that U.S. bankers are *not* total idiots—and I believe this to be a fair assumption—then it doesn't take a rocket scientist to figure out that—based solely upon the growth of foreign banks as compared with that of U.S. banks who are competing for the same assets—foreign banks operating in the U.S. have been given a competitive advantage.

**Q.3.** You state on page 8 of your testimony that the wholesale branches of foreign banks do not pay deposit insurance premiums, and are not subject to the CRA and other consumer statutes. In your view does that give foreign banks advantages in attracting deposits and underpricing American banks for the more highly rated borrowers in this country?

**A.3.** Yes. As discussed in my testimony before the Committee,

> ". . . foreign banks have major competitive advantages in pricing loans and deposits over U.S. banks. The cost of capital to U.S. banks has increased significantly through compliance with numerous regulations not imposed on foreign banks. Foreign banks conduct most of their activities in this country through branches of their main banks headquartered abroad. These branches do not pay deposit insurance premiums. They are not subjected nor involved in any Community Reinvestment Act requirements nor are they subject to a host of consumer statutes like those American banks are subjected to."

According to the Federal Deposit Insurance Corporation, most, if not all, compliance laws are tied to FDIC insurance. If an institution can avoid FDIC insurance, it can avoid compliance laws. This is precisely what foreign banks are doing. As a result, there is a tremendous savings in foreign bank operating costs which, in turn, plays a mammoth role in the pricing of those bank's products (loans).

Moreover, and as pointed out in the statement accompanying my testimony, many foreign banks are not subject to the Glass-Steagall Act and thus may engage in both commercial and investment banking at the same institution in the United States which in turn gives them access to global capital thus reducing their cost.

In summary, the inequality between foreign and U.S. banks imposes additional costs upon U.S. banks which can only place U.S. banks in a competitive disadvantage in attracting deposits and pricing services to highly rated borrowers in this country.

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ISBN 0-16-044118-8

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